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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 286

ALABAMA-TENNESSEE NATURAL GAS COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Alabama-Tennessee Natural Gas Company, Petitioner herein, respectfully prays that a writ of *certiorari* issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled cause on March 25, 1966.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit (App. pp. 1a-43a) is reported at 359 F. 2d 318 (1966). The opinions and orders of the Federal Power Commission (R. 126-77, 202-14) are reported at 31 F.P.C. 208 and 31 F.P.C. 928 (1964).

JURISDICTION

The judgment of the Court of Appeals (App. p. 44a) was entered on March 25, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Where the Federal Power Commission, the Court below and all parties agree that Congress, in enacting Section 167 of the Internal Revenue Code of 1954, intended to provide all industries, including companies regulated by the Commission, with an economic incentive to expand their facilities, can the Commission deprive such companies of the intended benefits by requiring them to be passed on to the companies' customers in the form of reduced rates?

2. Whether a regulatory agency denies the fair and adequate hearing required by the "due process" clause of the Constitution when it announces for the first time, twenty months after the close of the record, an intention to review prior judicially-approved Commission decisions on which there has been extensive industry reliance and thereafter, without reopening the record or according an opportunity to present evidence or cross-examine, undertakes to reverse such decisions on factual findings based on materials *de hors* the record?

STATUTES INVOLVED

The pertinent provisions of Sections 4(d) and 4(e) of the Natural Gas Act, 15 U.S.C. 717 c (d) and (e) and of Section 167 of the Internal Revenue Code of 1954, 26 U.S.C. 167, are set out in the Appendix, *infra*, pp. 45a-48a.

STATEMENT

Alabama-Tennessee Natural Gas Company (Alabama-Tennessee) owns and operates a natural gas pipeline system extending approximately 140 miles from an interconnection with its sole supplier, Tennessee Gas Transmission Company, at a point near Selmer, Tennessee, in an easterly direction to its terminus at Huntsville, Alabama. Alabama-Tennessee serves fifteen small resale customers and five direct sale customers. As of December 31, 1959, Alabama-Tennessee had a net plant in service of slightly more than $5,000,000 and an accumulated reserve for deferred taxes of $100,000 (R. 157). Because it transports and sells natural gas in interstate commerce for resale, the rates charged by Alabama-Tennessee for such sales are subject to regulation by the Federal Power Commission under the Natural Gas Act.

On February 3, 1964, the Commission, then including four newly appointed members (see App. p. 7a fn. 9), issued its Opinion No. 417 in which, by a bare 3-2 majority, the Commission completely reversed its prior construction of the Congressional intent with regard to Section 167 of the Internal Revenue Code of 1954. In so doing, it deprived Alabama-Tennessee of the benefits thereof by directing it to file reduced rates to reflect the temporary reduction in Federal income taxes resulting from its use for tax purposes of the liberalized method of depreciation as permitted by that Section (R. 153-54). On appeal, the Court below affirmed the Commission (App. p. 43a).

Section 167 of the Internal Revenue Code

In 1954, Congress, in order to stimulate further expansion and growth in the national economy, enacted what became Section 167 of the Internal Revenue

Code of that year. By that provision, Congress gave to taxpayers a new election, in computing depreciation for federal income taxes, between several liberalized depreciation methods and straight line depreciation[1] which had almost invariably been used previously. Under the liberalized depreciation methods thus permitted, the depreciation expense allowed a company for tax purposes is greater and the federal income tax lower during the early years of the life of the depreciable property than under straight line depreciation. However, this is offset by lower depreciation allowances for tax purposes, and hence higher taxes, in the later years of the property's life. Consequently, liberalized depreciation has no net effect, all other factors remaining constant, on a company's tax liability over the life of the property concerned.

Since federal income tax expense is one of the costs comprising the "cost of service" upon which the Commission fixes the rates of natural gas pipeline companies subject to its jurisdiction, the Commission has had to consider, in connection therewith, the rate effect to be given a company's use of liberalized depreciation. As shown below, for many years and indeed until its decision in the instant proceeding, the Commission had "normalized" the income taxes of such companies. By such normalization, the Commission computed the allowance for income taxes included in the company's cost of service on the basis of straight line depreciation and directed that the difference between the taxes paid and the normalized tax allowance be placed in a deferred tax reserve until needed to pay increased taxes in later years. Until so needed, the funds were

[1] As its name suggests, the depreciation under the straight line method is the same, year to year, over the life of the property.

available to the company for the financing of additional plant and equipment, but not for the payment of dividends or other distribution to its stockholders.

In contrast, in the instant proceeding, the Commission has required Alabama-Tennessee to "flow through" the benefits of liberalized depreciation, *i.e.*, to pass such benefits on immediately to Alabama-Tennessee customers in the form or reduced rates. The effect of such a requirement is to frustrate the intent of Congress by prohibiting the company from retaining and investing the deferred tax funds which become available through the use of liberalized depreciation, and to destroy any assurance that the company will be able to meet the increased tax obligations arising in the future as a result of the initial deferral of taxes through utilization of liberalized depreciation. But the Commission did not stop at directing flow-through to be applied to *future* plant additions. It also denied all earnings on plant constructed in *prior* years with funds generated through the use of liberalized depreciation despite the consistent and repeated pronouncements of the Commission and the subsequent judicial assurances to the contrary. In so doing, the Commission totally disregarded the fact that Alabama-Tennessee and other members of the industry elected to utilize the liberalized depreciation provisions of Section 167 of the Internal Revenue Code based upon these assurances.

The Commission's Prior Practice

For a period of ten years following the enactment of Section 167, the Commission consistently found that, in order to effectuate the intent of Congress, it was necessary to provide for the normalization of taxes and to permit a return on the funds generated thereby.

Shortly after the enactment of Section 167, the Commission instituted a rule-making proceeding on the petition of several pipeline companies which sought to remove the uncertainties relating to the rate-making and accounting procedures to be followed in dealing with liberalized depreciation permitted by Section 167. *Amere Gas Utilities Company, et al.*, 15 F.P.C. 760, 781 (1956). As a result of that proceeding, the Commission found that the use of liberalized depreciation resulted in a tax deferral rather than a tax saving (15 F.P.C. at 782). Further commenting that it did not have the power to "strike down an act of Congress if we think it unwise, or unnecessary to a particular industry, and enforce it only if it is in accord with our economic and regulatory philosophy" (*Id.* at 782), the Commission concluded that to require "flow through" of the tax deferrals resulting from the use of liberalized depreciation would frustrate "the clear and obvious Congressional intent" in enacting Section 167 (*Ibid.*)[2]

Subsequent to *Amere*, many pipeline companies relying on this formal Commission pronouncement, elected to invoke the benefits of the liberalized depreciation incentive offered them by Congress. This was further encouraged by the Commission itself when it consistently applied the normalization principle in the further proceedings as they arose and was upheld on

[2] In so holding, the Commission followed its own earlier decision in *Panhandle Eastern Pipe Line Co.*, 13 F.P.C. 53, 82 (1954), in which it had ruled that accelerated amortization for tax purposes under Section 168 of the Internal Revenue Code should be normalized in fixing the company's rates in order to effectuate the Congressional intent. This ruling was approved in *City of Detroit* v. *F.P.C.*, 230 F. 2d 810, 822 (D. C. Cir. 1955), *cert. denied*, 352 U.S. 829 (1956).

judicial review. *El Paso Natural Gas Co.*, 22 F.P.C. 260, 267 (1959), remanded on other grounds, *El Paso Natural Gas Co.* v. *F.P.C.*, 281 F. 2d 567 (5th Cir. 1960), *cert. denied*, 366 U.S. 912, (1961); *United Fuel Gas Co.*, 23 F.P.C., 127, 130-31 (1960), remanded on other grounds, *Cities of Lexington* v. *F.P.C.*, 295 F. 2d 109 (4th Cir. 1961); *Phillips Petroleum Co.*, 24 F.P.C. 537, 570 (1960), aff'd *Wisconsin* v. *F.P.C.*, 303 F. 2d 380 (D. C. Cir. 1961) aff'd, 373 U.S. 294 (1963); *Northern Natural Gas Co.*, 25 F.P.C. 431 (1961); *Kansas-Nebraska Natural Gas Co.*, 25 F.P.C. 448 (1961); *Panhandle Eastern Pipe Line Co.*, 25 F.P.C. 550 (1961); aff'd, *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 316 F. 2d 659 (D.C. Cir. 1963), *cert. denied*, 375 U.S. 881 (1963).

The Orders Under Review

During the period between 1954 and 1959, Alabama-Tennessee filed rate increases under Section 4(d) of the Natural Gas Act, solely to recoup increases in the cost of purchasing gas from its supplier.[3] At the hearing thereon, there did not appear to be any need to present any evidence in support of the Commission's normalization practice, since the Commission's treatment of the use of liberalized depreciation was well established and had been judically approved. Neither Alabama-Tennessee nor the Commission Staff presented any evidence on this subject. While an intervenor, Tennessee Valley Municipal Gas Association (Gas Association), the only party presenting evidence on this issue, offered

[3] As is usual with such rate increase filings, each was suspended for the statutory period of five months.

evidence in support of its position favoring "flow through", such evidence was of the same type and by the same witness as had been consistently rejected by the Commission in prior proceedings.

Twenty months after the close of the record and eleven months after the Examiner's proposed decision herein dated September 25, 1961, in which he adhered to normalization of liberalized depreciation, the Commission, on June 1, 1962, *for the first time,* indicated a possible departure from its prior determinations[4] by scheduling oral argument on the manner of determining the tax allowance to be included in Alabama-Tennessee's cost of service (R. 64-66).[5] Alabama-Tennessee sought rehearing but the Commission, holding its June 1, 1962 order to be merely interlocutory, treated Alabama-Tennessee's application as only a motion for reconsideration and denied it (R. 113-116). Following several delays,[6] oral argument was finally

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[4] While the Commission's order refers to several orders in which it had purportedly indicated an intent to reexamine the question, it should be noted that each of these orders was issued long after the record herein was closed and related to electric companies subject to regulation under another act.

[5] The Commission specifically requested that the oral argument be "directed toward the several possibilities for handling this matter, namely, use of the present procedure [normalization] with rates of return at 0, 1.5, or such higher rate as may be deemed to be in the public interest, or alternatively, use of the so-called 'flow-through' principle under which the reduction in taxes through the use of liberalized depreciation instead of straight-line depreciation, would be reflected in income taxes included in the pipeline's cost of service" (R. 65).

[6] In the meanwhile, the Commission entered its Opinion No. 360 deciding all other issues relating to Alabama-Tennessee's rates, but keeping the proceeding open to enable it to reconsider and reexamine the treatment of liberalized tax depreciation (R. 67-98).

held in May, 1963, in which, pursuant to the invitation in the Commission's June 1, 1962, order, there participated numerous *amici* who had not been parties in the case.

Thereafter, on February 3, 1964, the Commission issued its Opinion No. 417 and order here under review. Without any indication of changed circumstances and without reopening the record to permit cross-examination or the receipt of countervailing evidence, the Commission repudiated its prior consistent conclusion and determinations. Instead it found that the use of liberalized depreciation resulted not in a tax deferral, but rather in a tax saving for natural gas pipelines such as Alabama-Tennessee, which, according to the Commission, maintain "growing or stable plant for the foreseeable future" (R. 152). Further, the Commission found, again in the teeth of its prior decisions, that "Congress did not attempt to prescribe the manner in which [this] Commission should reflect such tax benefits in rates established under the Natural Gas Act (R. 152), and that flow-through will "effectively" meet "the fundamental objective of Section 167 of the Internal Revenue Code, to benefit the national economy by stimulating plant modernization and expansion" (R. 152). Accordingly, concluding that there was no "present factual justification" for treating the funds as deferred taxes that would normally be payable under straight-line depreciation (R. 153), the Commission held that Alabama-Tennessee's prospective rates "should reflect only the actual taxes currently payable during the applicable test year" (R. 153) and directed Alabama-Tennessee to file new rate schedules reflecting

the lower federal income tax allowance and the smaller rate base.[7]

Following the Commission's denial of its application for rehearing (R. 202-14), Alabama-Tennessee sought review in the Court below, which affirmed the Commission's decision. While recognizing that the Commission has performed an "about face" in a "singularly eccentric" manner (App. p. 37a), the Court below upheld the Commission's requirement that Alabama-Tennessee flow through to its customers the benefits from the use of liberalized depreciation as a matter within the Commission's special competence or discretion.

REASONS FOR GRANTING THE WRIT

Through a long series of Commission and Court decisions dealing with the rate treatment to be accorded natural gas pipeline companies in their use of liberalized depreciation authorized by Section 167, the industry was advised that the Commission sanctioned the concept of normalization and would provide at least 1½% return on the funds generated thereby. Since the industry exercised its statutory option on the basis of these court-approved determinations in electing to utilize liberalized depreciation, these consistent and judicially sanctioned pronouncements have become imbedded in the economic fabric of pipeline expansion programs. In the instant case, the Commission, with the approval of the Court below, has not limited it-

[7] While permitting Alabama-Tennessee to retain the deferred tax funds accumulated in the past as a contingency reserve (not a segregated fund), to offset any increased taxes in the future resulting from a decline in total tax depreciation deduction (R. 153), the Commission directed that Alabama-Tennessee not be allowed any return on these funds or the facilities constructed therewith.

self to repudiating normalization in favor of flow through with regard to future *plant* additions; it has gone much further and denied *all* earnings on plant constructed in *prior years* with the funds previously generated by the use of liberalized depreciation, all in the teeth of the industry action taken in reliance upon prior judically approved precedents.

Not only does the decision below thus approve a critical "about-face" by the Commission, but it conflicts with the decision of the Court of Appeals for the District of Columbia Circuit in *Panhandle Eastern Pipe Line Co.* v. *F.P.C.*, 316 F. 2d 659 (1963) *cert. denied*, 378 U.S. 881 (1963). Moreover, the decision below is demonstrably unsound; because it is based (1) upon a misconstruction of the purport and intent of Section 167, and (2) upon admittedly critical findings made on a bob-tailed record and without adequate notice or opportunity to Alabama-Tennessee to cross-examine or submit rebuttal evidence. Since, in addition, the question admittedly is of far reaching importance, potentially affecting virtually every natural gas pipeline company and electric utility subject to Commission regulation (R. 127-8), review by this Court is clearly called for.

1. The decision of the Court below, we submit, conflicts with the decision of the D. C. Court of Appeals in *Panhandle Eastern Pipe Line Company* v. *F.P.C, supra.* In contrast to the holding below that the Commission's switch from normalization to flow through of the benefits from the use of liberalized depreciation does not violate the Congressional purpose in enacting Section 167 (App. p. 27a), the D. C. Court of Appeals has taken a completely opposite view of the legislative intent underlying Section 167 and hence has reached

a result wholly inconsistent with that of the Court below.

Formulating the question presented in *Panhandle* as (316 F. 2d at 661-2):

> "* * * whether the congressional purposes underlying the tax and gas acts are effectuated by permitting a rate of return on the funds generated by the use of liberalized depreciation no higher than that required to provide the company with 'a sufficient incentive to continue to use liberalized depreciation.'"

the D. C. Court of Appeals has expressly recognized not only that:

> "* * * the legislative history reveals that Congress intended the statute 'to have far-reaching economic effects' extending to 'all segments of the American economy.' Liberalized depreciation was seen as a means toward a broad economic goal; it was expected to 'assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living'." (*Id.* at 662)

but also that:

> "To set this economic spiral in motion, producers must, of course, be willing to invest in plant and incur the attendant risks. Congress permitted 'acceleration in the speed of the tax-free recovery of costs [because it considered this] of critical importance in the decision of management to incur [such] risks.' * * *" (*Ibid.*)

Further accepting the thesis—with which all nine judges sitting *en banc* agreed unanimously—that normalization was necessary as one step toward providing business with an incentive to invest in the requisite

new facilities, the majority of the D. C. Court of Appeals concluded that the 1.5% return, there allowed by the Commission, provided sufficient incentive for the continued use of liberalized depreciation and hence appropriately implemented the purpose of Section 167 (*Id.* at 663).[8]

Notwithstanding the suggestion of the Court below to the contrary (App. p. 15a), *Panhandle* does not leave the way open for the Commission to switch to the flow-through principle. The fundamental premise of the *Panhandle* decision is that if all the benefits of Section 167 are taken from the taxpayer as they would be by the Commission's adoption of the flow-through principle, the incentive provided by liberalized depreciation would be eliminated and the Congressional purpose thereby frustrated. Since it is only under normalization that deferred tax funds are generated, it is obvious that the question of the proper return to be allowed on such funds is only reached if the accumulation of the funds themselves is proper. Consequently, the Court below plainly erred in failing to recognize that the clear effect of the D. C. Court of Appeals' decision is that normalization is essential to effectuate the Congressional intent. As the latter explicitly stated:

> "* * * the congressional purpose could not be adversely affected *unless the regulated companies were prevented from re-employing recovered funds* at a sufficient profit to provide incentive to initial investment" (316 F. 2d at 662; emphasis supplied).

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[8] In a vigorous dissent, four judges were of the firm view that the allowance of a full return on the tax accruals was required by the legislative intent behind Section 167 (316 F. 2d at 663, *et seq.*).

"Since there is no indication that Congress intended to bestow upon the producers *qua* producers any benefits beyond those necessary to provide incentives to investment, we conclude that, if a return of 1.5 percent taken with the other advantages does provide such incentive, the Commission's decision would be consistent with the congressional policy underlying the tax statute" (*Id.* at 663).

2. The legislative history of Section 167 reveals the *validity* of the D. C. Court of Appeals' thesis in *Panhandle, supra,* that normalization effectuates the Congressional intent, and the *error* in the holding below that the regulatory treatment of liberalized depreciation was left to the "special competence" or "discretion" of the Commission.

Prior to the enactment of Section 167 in 1954, Congress had considered at length the various possible changes in the tax laws which it might adopt to stimulate the national economy. By the enactment of Section 167, Congress made known its decision to extend direct tax relief to businesses in the form of liberalized depreciation. This it did in order to provide tangible benefits in the form of increased after-tax revenues and cash flow to businesses investing in new plant and thereby stimulating the national economy. For example, both the House Committee on Ways and Means and the Senate Committee on Finance, affirmed this purpose in identical language:[9]

"More liberal depreciation allowances are anticipated to have far-reaching economic effects. The

[9] Report of the House Committee on Ways and Means, to accompany H.R. 8300, H. Rep. No. 1337, 83rd Cong., 2d Sess., p. 24 (1954). Report of the Senate Committee on Finance, to accompany H.R. 8300, S. Rep. No. 1662, 83rd Cong., 2d Sess., p. 26 (1954). Much of the House Report is repeated almost verbatim in the Senate Report.

> incentives resulting from the changes are well timed to help maintain the present high level of investment in plant and equipment. The acceleration in the speed of the tax-free recovery of costs is of critical importance in the decision of management to incur risk. The faster tax write off would increase available working capital and materially aid growing businesses in the financing of their expansion."

Similarly, the legislative history is clear that Congress intended no limitation on the types of tangible depreciable assets upon which liberalized depreciation could be taken nor upon the types of businesses or industries which could take liberalized depreciation under Section 167. Also, the legislative history clearly indicates that Congress intended the immediate tax benefits to be available to all businesses. There is nothing to indicate that these benefits would be subject to later nullification by the action of regulatory agencies. As stated by the House Ways and Means Committee (H. Rep. No. 1337, 83rd Cong., 2d Sess., p. 24):

> ". . . For *all* segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." (emphasis supplied).

In the same vein, the Senate Finance Committee commented (S. Rep. No. 1662, 83rd Cong., 2d Sess., p. 25):

> "The liberalized depreciation methods provided in the bills are to apply to *all* types of tangible depreciable assets, including farm equipment, machinery and buildings, rental housing, and industrial and commercial buildings as well as machinery, and equipment. * * *" (emphasis supplied).

While both the Commission and the Court below recognized Section 167 as a "tax incentive" provision, they disregarded the nature of the incentive intended by Congress and by so doing they committed further serious error. In lieu of the direct incentive by which Congress intended to encourage business investment and hence to stimulate the economy, the Commission, with the approval of the Court below, found, without any evidentiary support that a comparable result could be achieved by other means, namely, that reduced rates would stimulate gas sales which in turn would increase demand and hence also stimulate the economy (R. 148-9).

But this is not the method adopted by the Congressional majority in enacting Section 167. Indeed, the Commission's approach precisely accords with the rejected views of the Congressional minority,[10] which opposed Section 167 and, like the Commission, favored stimulating the economy by encouraging consumer demand through tax reductions rather than through enactment of Section 167. Since Congress, however, deliberately rejected this *indirect* approach and chose instead the *direct* business stimulus embodied in Section 167, the Commission's purported "special competence" or "discretion" clearly does not ex-

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[10] As set out in H.R. Rep. No. 1337, 83rd Cong., 2d Sess. (1954) at App. B 4, it was the view of the Committee minority:

> "* * * that the most effective way to [offer incentives to businesses] * * * is not through tax reductions for corporations and investors, but tax reductions which will immediately increase purchasing power in the hands of consumers. * * * With all kinds of incentives offered them, businesses will not expand where they have no markets."

See also: "Liberalized Depreciation; About-Face By The F.P.C.", 30 Va. L. Rev. 298-336 (Mar. '64).

tend to permitting it to do what it expressly recognized in *Amere* it had no power to do, namely, "* * * to strike down an act of Congress if we think it unwise, or unnecessary to a particular industry, and enforce it only if it is in accord with our economic and regulatory philosophy" (15 F.P.C. at 782).

The Commission and the Court below further erred in their assumption that giving effect to Section 167 as intended by Congress might create a conflict between Section 167 and the Natural Gas Act with the consequence of "interfering with the FPC's duty [under the Natural Gas Act] to fix 'just and reasonable rates' " (App. p. 20a). The fact is, however, that the effectuation of the Congressional purpose underlying Section 167 does not in any way interfere with the discharge of the Commission's responsibilities under the Natural Gas Act.[11] This is clearly shown by the series of court decisions set forth at page 7, *supra*. Congress intended the taxpayer company, not the consumer, to receive the benefits of Section 167 as an incentive for plant expansion. Like the comparable Section 168, relating to accelerated amortization, Section 167 "unlike the Natural Gas Act itself, is not for consumer benefit" and has "a different public policy [which] should be given effect as intended by Congress" *City of Detroit* v. *F.P.C.*, 230 F. 2d 810, 822 (D.C. Cir., 1955), *cert. denied*, 352 U.S. 829 (1956).

Moreover, permitting the taxpayer companies to retain the benefits of Section 167 does *not* result in

[11] In this connection, it is to be noted that normalization not only effectuates the Congressional purpose underlying Section 167, but is, in fact, the only way by which future customers can be protected against increased future taxes resulting from the use of liberalized depreciation.

increasing the rates to the customers. As the D.C. Court of Appeals stated in *City of Detroit, supra* at 822:

> "* * * the [normalization] solution of the Commission does not result in higher rates to the consumer. It simply does not operate to reduce them. It aids Panhandle but neither aids nor harms petitioners. * * *"

See also, *United Fuel Gas Co.*, 23 F.P.C. 512 where the Commission said at 513: "The customer is not injured by liberalized depreciation; it pays a rate as though this tax incentive did not exist". In a word, Section 167 concerns only the taxpayer companies and the United States Treasury without in any way, involving the consumers of natural gas or Commission regulation under the Natural Gas Act.

3. The above substantive errors are compounded by the serious procedural infirmities infecting the Commission's factual findings underlying its conclusions. The Court below expressly recognized that the procedure followed by the Commission in arriving at these findings "invited adverse criticism" (App. p. 3a) and that it was "singularly eccentric" (App. p. 37a). However, the Court concluded that "taken separately or cumulatively, these eccentricities do not rise to the level of fatal procedural defects" (App. p. 37a). In so holding, the Court below, we submit, committed egregious error.

The Commission's conclusions herein are plainly predicated on several significant and critical findings of fact. Thus, the Commission's conclusions are based not only on its finding that flow through would in fact increase demand and hence stimulate plant expansion and the economy but also on its finding that liberalized depreciation results in a tax saving rather than a tax

deferral. Indeed, the Commission itself recognized as critical the "factual issue":

> "* * * whether Section 167 tax benefits will occasion a reasonably certain increase in future taxes or whether they essentially are a permanent tax reduction * * * the tax consequences of liberalized depreciation must be evaluated in the light of expert judgment as to probable future developments in such areas as demand for gas; plant capacity; the adequacy of gas reserves; the level of plant construction costs and the likelihood and impact of declining plant situations." (R. 142)

The record evidence admittedly was very limited—i.e., "* * * the only pertinent testimony came from one witness. And this lone witness was the intervenor's, not the Commission's witness" (App. p. 37a).[12] The Commission, in order to resolve these factual matters, improperly relied on untested predictions and estimates culled from secondary sources *de hors* the record which in most instances could not have withstood the scrutiny of cross-examination or rebuttal evidence had the record been reopened as it should have been.

The Commission's action was particularly inappropriate as these several factual findings of the Commission relate to highly controversial and speculative matters. In sharp contradiction to its findings here, the Commission itself had previously taken the position that the assumption of a continued plant growth by gas pipelines is "at best largely speculative and conjectural"[13] and further that:

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[12] As noted *supra*, pp. 7-8, comparable evidence by this witness on this subject had previously been consistently rejected by the Commission.

[13] See the Commission's Brief in opposition in *People of the State of California* v. *F.P.C.*, No. 599 O.T. 1960, p. 15. See, also p. 17.

> "Continued expansion for the indefinite future can more readily be assumed for the electric power and telephone industries than for gas pipelines, which are dependent on the continuing discovery of exhaustible gas reserves"[14]

In addition, contrary to the Court below, "the initial prejudice from lack of notice" which the Court found to exist did *not* "evaporate" (App. p. 40a). The Court below sought to justify its contrary conclusion by claiming that Alabama-Tennessee had failed to make appropriate efforts to introduce evidence subsequent to the Commission's scheduling of the depreciation issue for oral argument by its June 1, 1962 order issued twenty months after the record herein had been closed.[15]

The fact is that Alabama-Tennessee specifically and at length objected, in its applications for rehearing both to the June 1, 1962 order and to the Commission's Opinion of February 3, 1964, to the absence of an adequate record on which to decide the issues raised in said orders. Plainly, therefore, the Commission's "about face" was based on procedure which is not

[14] *Ibid.*

[15] It is unclear from the opinion below just how the Court viewed the situation prior to the issuance of the June 1, 1962, order. Thus, while the opinion states at one point that "petitioner received enough notice of [the] significance [of the issue] to have protected itself by rebuttal evidence before the end of the hearing" (App. p.38a), it is stated in the very next paragraph (App. pp. 38a-39a):

> "*At the time of the hearing* it was reasonable for petitioner to rely on the Commission's then well-established policy of allowing normalization. It was not unreasonable for the petitioner to assume that the Commission's failure to offer witnesses on flow-through normalization indicated that the Commission had no intention to reverse itself." (Emphasis supplied.)

merely "singularly eccentric" but which operated effectively to deny a fair hearing to Petitioner and the natural gas industry in general.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 23, 1966

APPENDIX

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 21610

ALABAMA-TENNESSEE NATURAL GAS COMPANY,
Petitioner,

versus

FEDERAL POWER COMMISSION, *Respondent,*

Petition to Review an Order of the Federal Power Commission.

(March 25, 1966.)

Before WISDOM and GEWIN, Circuit Judges and BREWSTER, District Judge.

WISDOM, Circuit Judge: Alabama-Tennessee Natural Gas Company, a federally regulated pipeline company, petitions the Court to review and set aside an about-face order of the Federal Power Commission.[1] This order establishes ratemaking principles reflecting the economic benefits the petitioner derives from using liberalized (accelerated) depreciation allowed the business community generally by Section 167 of the Internal Revenue Code of 1954.[2]

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[1] Opinion No. 417, 31 F.P.C. 208 (Feb. 3, 1964); rehearing and stay denied, Opinion No. 417-A, 31 F.P.C. 928 (April 15, 1964).

[2] Congress enacted Section 167 as an investment incentive for the business community generally. It enables taxpayers to write off between two-thirds and three-quarters of post-1933 investments

In a rate increase proceeding by Alabama-Tennessee, the Commission ruled that the company may no longer "normalize"[3] accelerated depreciation, accumulate reserves for the deferred tax liability, and receive a return on the amounts already accumulated. In addition, the Commission required Alabama-Tennessee to flow through to customers in the form of reduced rates the benefits resulting from liberalized depreciation. This ruling reverses the Commission's

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in the first half of a property's estimated life. In pertinent part, Section 167 provides:

"§ 167. Depreciation

"(a) General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

"(1) of property used in the trade or business, or

"(2) of property held for the production of income.

"(b) Use of certain methods and rates.—For taxable years ending after December 31, 1953, the term 'reasonable allowance' as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

"(1) the straight line method,

"(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

"(3) the sum of the years-digits method, and

"(4) any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

"Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a)."

[3] See Section I-A of this opinion.

earlier ratemaking treatment of liberalized depreciation.[4] Fundamental to the Commission's decision is its finding that in a stable or expanding industry, such as the natural gas industry, accelerated depreciation results in true tax savings for the foreseeable future.

Alabama-Tennessee makes two main points. First, the petitioner contends that the challenged order[5] conflicts with the intent of Congress as expressed in Section 167 and therefore arbitrarily deprives the company of the benefits of congressionally sanctioned accelerated depreciation. Second, the petitioner contends that the Commission's procedures were unfair not only to the petitioner but to the entire natural gas industry. We reject these contentions. (1) Giving full weight to the Commission's broad responsibilities under the Natural Gas Act and its special competency to choose between competing theories of accounting for ratemaking purposes, on balance we must uphold the order. (2) The approach and methods the Commission adopted in this case invited adverse criticism, but we cannot say that the procedure was so unfair and prejudicial as to have deprived the petitioner or the natural gas industry of a fair hearing.

* * *

Alabama-Tennessee is one of the smallest interstate gas pipeline companies subject to the Commission's jurisdiction. Its pipeline system extends 140 miles from an interconnection with its sole supplier, Tennessee Gas Transmission Company, at a point near Selmer, Tennessee to its terminus at Huntsville, Alabama. Alabama-Tennessee

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[4] Less than three years before, the Commission specifically approved normalization and allowed a return of 1.5 per cent on the deferred tax reserves. See Northern Natural Gas Co., 25 F.P.C. 431 (1961).

[5] The petitioner seeks review under Section 19(b) of the Natural Gas Act, Act of June 21, 1938. 52 Stat. 821-833, as amended (15 U.S.C. §§ 717-717w).

serves five direct sales customers and fifteen small resale customers; all but one are municipal distributors. As of December 31, 1959, the company's net plant in service had a value of about $5,000,000 and an accumulated reserve for deferred taxes of $100,000.

The proceedings originated in four rate increase filings between 1954 and 1959 under Section 4(d) of the Act. Each of the filings was suspended by the Commission under Section 4(e). After suspension for five months, each became effective, subject to refund, until superseded. The Commission consolidated the four cases for a hearing that commenced July 13, 1960. The Tennessee Valley Municipal Gas Association intervened in opposition to each of the four increased rates. The intervenor introduced evidence to show that the excess of normalized taxes over actual taxes constitutes tax savings and not merely tax deferrals. Alabama-Tennessee did not object to this evidence and offered no evidence in rebuttal. The Commission introduced no evidence on this point.

Alabama-Tennessee, in its application for a rehearing, explained that it did not introduce rebuttal evidence because at the time the hearing was held it had "no possible reason to contemplate the unprecedented action which the Commission has taken in this case." Indeed, both "Alabama-Tennessee and the Commission's staff made their evidentiary presentations on the assumption that the principles which the Commission had established with respect to liberalized depreciation could be relied upon. The Commission's rulings had been consistent since 1956."[6]

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[6] Amere Gas Utilities Co., 15 F.P.C. 760 (1956); El Paso Natural Gas Co., 22 F.P.C. 260, 265-69 (1959), reversed on other grounds in El Paso Natural Gas Co. v. Federal Power Commission, 5 Cir. 1960, 281 F. 2d 567; United Fuel Gas Co., 23 F.P.C. 127, 130-31 (1960); Phillips Petroleum Co., 24 F.P.C. 537, 570 (1960); City of Detroit v. Federal Power Commission, D.C. Cir. 1955, 230 F. 2d 810, 821-22, cert. denied 352 U.S. 829 (1956). See also In the Matter of Treatment of Federal Income Taxes as Affected by Accelerated Amortization, 12 F.P.C. 369 (1953).

September 25, 1961, the Examiner issued his decision. He disallowed about $500,000 of $1,500,000 of proposed increases, but rejected the intervenor's contentions. He allowed normalization of income taxes and a 1.5 per cent return on the deferred tax reserve.[7] The intervenor excepted to this ruling and asked the Commission to reexamine its position on liberalized depreciation.

June 1, 1962, the Commission issued an order severing the issue of liberalized depreciation from other matters in the case and setting down that issue for special oral argument for July 10, 1962. The severance order provided, in part, that:

"Specifically, we desire to hear arguments directed toward the several possibilities for handling this mat-

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[7] The examiner commented: The Commission as a matter of policy has allowed the benefits of such liberalized depreciation to be retained by the pipeline company. In this connection it may be pointed out that liberalized depreciation, under Section 167 of the Internal Revenue Code, only shifts costs from one period to another. It does not relieve the taxpayer from the eventual necessity of paying such costs. The determination by a taxpayer as to whether to take advantage of such liberalized depreciation is a matter of sound business discretion and should be considered in relation to its effect upon the financial structure of the taxpayer, rather than upon any consideration of its effect upon third parties or the benefits which they might receive therefrom.

From the standpoint of customers of Alabama-Tennessee, the allowing of that company to retain the benefits of the liberalized depreciation which it is permitted to take under Section 167 of the Internal Revenue Code raises only one question and that is whether certain costs should be paid now by present rate payers or passed on to future rate payers when it becomes necessary for Alabama-Tennessee to meet the postponed liability incurred by it under the Federal Income Tax statutes. It appears equitable that these costs should be paid by the present rate payers rather than by some future generation of rate payers, at a time when gas rates will probably be much higher than they are now. It is therefore found that the retention by Alabama-Tennessee of the temporary benefits due to accelerated depreciation, as provided for in the Internal Revenue Code, is in the overall public interest and should be permitted in these rate determinations."

ter, namely, use of the present procedure with rates of return at 0,1.5, or such higher rate as may be deemed to be in the public interest, or alternatively, use of the so-called *'flow-through'* principle under which the *reduction in taxes* through the use of liberalized depreciation instead of straightline depreciation, would be reflected in income taxes included in the pipeline's cost of service. We believe we would be aided in our consideration of this problem by the participation as *amici* either in the oral argument, or by the filing of written briefs, by any person, company, association or governmental authorities having an interest in the problem. * * *"

June 13, 1962, the Commission issued its order and Opinion No. 360, 27 F.P.C. 1180, adopting the Examiner's decision on most issues but reserving for later decision the liberalized depreciation issue. Any change of policy on depreciation would be "applicable to Alabama-Tennessee's rates herein prescribed from and after the date of such decision."

The petitioner did not seek court review of that order; the petitioner objected, in an "Application for Rehearing", to the severance and special argument of the liberalized depreciation issue that would affect rates from April 4, 1960. The petitioner points out that these proceedings began in 1954; that they were not heard until 1960 in spite of strenuous efforts to have its applications disposed of expeditiously; that the matters were submitted to the Commission in October 1961 and were not finally ruled upon until June 13, 1962; that since the Commission has decided the rate-increase case, petitioner no longer has any matter pending before the Commission. The petitioner contends that the Commission has "no authority to continue this proceeding in an open-ended manner as a vehicle for instituting what is tantamount to a rulemaking proceeding concerning an issue of widespread interest and importance

to the entire gas and electric industry but having applicability to a single company—Alabama-Tennessee." The petitioner challenges the validity of the Commission orders, the fairness of its procedures, and the propriety of converting this minor rate case into a cause celebre in which "any person . . . having an interest" in the subject of the treatment of liberalized depreciation was "invited" into the proceeding. Without delay, the Commission denied the petition.[8]

May 16, 1963, after several delays, Alabama-Tennessee, the intervenor, and thirty-four amici participated in the oral argument on the liberalized depreciation issue. February 3, 1964, the Commission, by a bare majority,[9] issued

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[8] The Commission stated, in part:

> "[T]he issues set for further briefing and argument were raised in these proceedings; and * * * contrary to the applicant's contention, that nothing is pending, Opinion No. 360 issued June 13, 1962, 27 FPC 1180, recites that the rates therein prescribed are subject to possible adjustment upon 'further argument as provided in the Commission's order of June 1, 1962 herein.' (Op. 360.) Alabama-Tennessee's failure to present evidence after the issues were raised and testified to by an intervener, was a matter of its own choice.
>
> In seeking to determine issues which are in controversy in the proceedings, we place no additional burden upon the respondent in the case. We are of the further view that in the resolution of those issues we may in our discretion request such aid as *amici* may be able to render. We believe Alabama-Tennessee's contentions to be without merit." 28 F.P.C. at 241.

[9] Counsel for the Commission noted in his brief that four of the five members of the Commission were newly appointed and therefore had not previously struggled with the problem of liberalized depreciation. The five members of the Commission from October 13, 1961, when the exceptions were filed to the denial of rehearing on April 15, 1964, were Joseph C. Swidler, Chairman, who took office June 26, 1961; Howard V. Morgan, June 28, 1961; Jerome K. Kuykendall, May 16, 1953; Lawrence J. O'Connor, Jr., August 14, 1961; Charles R. Ross, September 29, 1961; Harold C. Woodward (vice Jerome K. Kuykendall), March 30, 1962; and David S. Black (vice Howard V. Morgan), August 30, 1963.

Opinion No. 417 and the order here under review. In its opinion the Commission emphasized that for Alabama-Tennessee, the decision is "the final element in determining a just and reasonable level of return"; for the various other pipeline companies, the decision is only "a proposed" or "tentative decision." See F.P.C. Rules of Practice and Procedure § 1.30(b), 18 C.F.R. § 1.30(b).

The Commission made the following findings. (1) The use of liberalized depreciation under Section 167 of the Internal Revenue Code results in a "permanent reduction" of federal income taxes by natural gas pipelines maintaining either "a growing or stable plant." Alabama-Tennessee will "maintain a growing or stable plant for the foreseeable future." (2) "Congress did not attempt to prescribe the manner in which [the] Commission should reflect such tax benefits in rates established under the Natural Gas Act." (3) Rate flow-through will "effectively" meet "the fundamental objective of Section 167 to benefit the national economy by stimulating plant modernization and expansion." (4) Alabama-Tennessee should retain deferred tax balances accumulated in the past "as a contingency reserve (not a segregated fund) to offset any increased taxes in the future resulting from a decline in total tax depreciation deductions." (5) Alabama-Tennessee's prospective rates "should reflect only the actual taxes currently payable during the applicable test year" (1960), since there is no "present factual justification" for deferring taxes that normally would be payable under straight-line depreciation. (6) "Alabama-Tennessee and other natural gas companies similarly situated" are not entitled to the "specific return of 1.5 per cent to be earned upon the portion of the rate base equivalent in amount to the accumulated 'deferred tax funds' "; indeed they are not entitled to any return upon such "consumer-contributed capital". Based on these findings the Commission ordered Alabama-Tennessee to file new rate schedules

reflecting the lower federal income tax allowance and the lower rate base found to be just and reasonable.

April 15, 1964, in Opinion 417-A, the Commission denied Alabama-Tennessee's application for rehearing and for a stay.[10] The Commission explained that Opinion 417 did not constitute a rule of general applicability.[11]

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[10] Alabama-Tennessee advised the Commission May 5, 1964, that it intended not to use liberalized depreciation commencing with taxes payable for 1963. By letter order of July 13, 1964, the Commission objected that this was a "single isolated factor affecting only the tax element of its over-all cost of service" and ordered Alabama-Tennessee to file reduced rates within seven days. Alabama-Tennessee filed with this court a motion of stay of the opinion and orders and requested the Commission to extend the time for filing the reduced rates until disposition of the appeal. The Commission granted the extension on the condition that the petitioner resume the use of liberalized depreciation for income tax purposes and continue use of the Commission's prescribed tax accounts pending the outcome of this proceeding.

[11] "While the liberalized depreciation issue in the case is of general interest, the case is solely a determination of just and reasonable rates for Alabama-Tennessee. Precedents of wide application are customarily established in cases in which only a single company is a party. An administrative agency may of course proceed by a rule-making proceeding but it certainly is free to arrive at general principles in individual cases. No question could have been raised concerning the propriety and legality of our procedures even if we had heard argument from only the parties in this case. Certainly our action in inviting the participation of other interested persons as *amici* to give them an opportunity to participate in the decision on a precedent of possible industry-wide applicability does not mean that the Commission has committed error. The position maintained by INGAA leads to the paradoxical result that a regulatory body may determine a policy of broad import and substantial impact in an individual proceeding without hearing from interested persons who are not parties to the case but is in error if it affords all persons who may be affected an opportunity to present their views as *amici* prior to final decision."

Large sums are involved and are mounting. In 1960 when the Commission held its first hearing on the issue, the aggregate total of the accumulated tax reserves of natural gas pipeline companies was about $150 million. December 31, 1963, it was $304 million. The petitioner's reserve at that time was $213,651.[12]

I.

A. *Normalization/flow-through.* In the FPC's "rate base-rate of return" system[13] the ratepayers of a regulated utility pay a rate sufficient to return to the utility the cost of service plus a specified rate of return on the utility's capital investment. Taxes are part of the utility's cost of service to be reimbursed by the taxpayers. When the deperciation is normalized, the ratepayers are charged not the actual income taxes paid but a hypothetical larger

[12] These figures from the Commission's brief are based on the Commission's Statistics of Natural Gas Companies compiled from reports made in compliance with FPC regulations.

[13] "In Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333, the Supreme Court approved use of the 'prudent investment' rate-base method for establishing rates to be charged by natural gas companies. . . . [R]ates are considered 'just and reasonable' if they will return to the company a certain percentage of profit on its rate base. The rate base is a figure representing the money prudently invested in the properties and equipment utilized in the company's transmission and production business. The percentage of profit prescribed by the Commission depends upon a variety of factors, such as the risks of the business, the necessity for attracting capital, and the desirability of lower cost of gas to the public. In order to return a profit on the rate base the rates are set high enough to recover all costs of service, including taxes, depreciation, depletion, and all operating expenses chargeable to production and transmission." City of Detroit, Michigan, etc. v. Federal Power Commission, D.C. Cir. 1955, 230 F. 2d 810, 813. See also Bonbright, Principles of Public Utility Rates, 147-283 (1961); Francis, Rate Regulation of Natural Gas Companies by the Federal Power Commission, 19 Law & Contemp. Prob. 413, 417-33 (1954).

figure for the taxes computed as if depreciation were figured on a straight-time basis. The difference between the actual taxes paid and the larger hypothetical amount for taxes charged to the ratepayers is accumulated in a "deferred tax" account. The funds in this account are available to the company as working capital free of any charges for interest or dividends. As even the dissenting commissioners pointed out, these funds come from the ratepayers.[14] This raises the question whether the funds are capital entitled to a "return"; if so, at what rate.[15]

Under the flow-through treatment of liberalized depreciation, the ratepayers reimburse the utility for federal income taxes the regulated utility actually pays. The utility does not accumulate capital funds that are, in effect, enforced contributions from consumers. Flow-through is in accord with the established principle the Commission has "consistently held that consumers should be charged for only the actual liability for Federal income taxes. . . ." *United Fuel Gas Company*, 12 F.P.C. 251, 264-65 (1953).

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[14] ". . . Since this capital represented by the reserve for deferred Federal income taxes is available to the company without charge, no recovery is required for that component in estimating the cost of capital. . . . This is warranted . . . by the . . . fact that the funds for normalizing the tax expense and accumulating the reserve are derived from consumers rates. . . . [T]here is no cost for this capital. . . ." 31 F.P.C. at 231.

[15] One authority has said: Normalization is popular with the public utility industries since, from their point of view, it has the charm of imposing upon consumers the obligation to pay deferred-tax allowances which, instead of being transmitted forthwith to the United States Treasury, are to be treated as capital investments entitled indefinitely to the enjoyment of a 'fair rate of return' for the benefit of the corporate stockholders. . . . Support for this position of the industry has been forthcoming from the Federal Power Commission [citing *Amere*] and from a few state commissions. But I have never seen a plausible defense of this claim to the enjoyment of a profit on funds not contributed by the corporate investors." Bonbright, Principles of Public Utility Rates 220 (1961).

Under traditional regulatory concepts, utility company shareholders (investors), not the consumers, furnish the capital necessary for the operation of the business. *Railroad Commission of Louisiana* v. *Cumberland Telegraph and Telephone Company*, 1909, 212 U.S. 414, 424, 29 S. Ct. 357, 53 L. Ed. 577; *Lindheimer* v. *Illinois Telephone Company*, 1934, 292 U.S. 151, 169, 53 S. Ct. 658, 78 L. Ed. 1182. The consumer pays a fair return on the utility's capital and in addition pays the cost of operation including taxes, but:

> "* * * [I]f the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers . . .are required to provide, in effect, capital contributions . . . to secure additional plant and equipment upon which the utility expects a return." *Lindheimer*, 292 U.S. at 169.

Lifetime depreciation on a single item of property is of course the same whether the utility elects straightline or accelerated depreciation. Under conventional accounting principles, therefore, the full amount of the value of the item less salvage would be a deductible expense. Conventional accounting, however, does not take into consideration the effect of applying liberalized depreciation to a utility's total assets which are, of course, subject to a continuing cycle of obsolescence and renewal. If the industry is stable or expanding, requiring the utility's *continued reinvestment in plant equal to or in excess of plant retirement*, a program of liberalized depreciation produces true tax savings because there is no reduction in the tax reserve fund.[16]

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[16] See Bonbright, Principles of Public Utility Rates, 218-223 (1961); Davidson, Accelerated Depreciation and the Allocation of Income Taxes, 33 Accounting Rev. 173 (1958); Comment, Liberalized Depreciation: About Face by the FPC, 50 Va. L. Rev. 298, 301 (1964); Note, Utility Ratemaking and Section 167, 69 Harv. L. Rev. 1097, 1102 (1956).

B. *Commission Policy and Judicial Review.* Initially, the Commission adopted the normalization approach for Section 168 of the Internal Revenue Code, providing for rapid tax amortization of emergency facilities to aid in mobilization for the Korean War.[17] *Amere Gas Utilities Company,* 15 F.P.C. 760, (1956), was the first case before the Commission after enactment of Section 167. In that case the presiding examiner found that use of a liberalized depreciation produced a tax savings not a tax deferral.[18] Notwithstanding, he approved normalization because he believed that Section 167 established a "formula for rate-making which would result in all income tax savings becoming the property of the owners of the business rather than the ratepayer". 15 F.P.C. at 773. The Commission affirmed the examiner but did say that the "statutory formula," as applied to regulated utilities, was contrary

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[17] Int. Rev. Code of 1939, § 124A (now Int. Rev. Code § 168). Accelerated Amortization is "a grant by our government to a certificate holder of an interest free loan." The customers "will pay the same rates, no more, no less." Treatment of Federal Income Taxes as Affected by Accelerated Amortization, 12 F.P.C. 369 (1953).

[18] "Consideration of the foregoing leads inevitably to the conclusion that assuming the continuation of the present statutory provisions, and assuming the continuation of at least some growth in petitioners' plant (that unless an assumption is made no purpose will have been served by petitioners' proposal), the aggregate annual depreciation under one of the liberalized depreciation methods will always be greater than under the straight-line methods, and under the former the accumulated depreciation will always be greater than under the latter. Under such circumstances there would never be a reduction in the overall income tax reserve but rather the freezing of income tax payments at amounts less than would otherwise be required. The result is, it is believed, properly characterized a 'tax saving.'" (15 F.P.C. at 773.)

to the Commission's regulatory philosophy and the "present traditional method" of treating depreciation expense.[19]

Until the Alabama-Tennessee proceeding, Commission rulings religiously followed *Amere*. *El Paso Natural Gas Company*, 22 F.P.C. 260 (1959),[20] involved both Sections 167 and 168. The Commission held that the Examiner "followed the intentions of Congress in permitting *El Paso* to retain the . . . tax advantages"; each section permits normalization for ratemaking purposes. The congressional intent was "conclusive". In *Northern Natural Gas Company*, 25 F.P.C. 431 (1961),[21] the FPC allowed normalization but permitted a return of only 1.5 per cent on the accumulated tax deferral funds. In *Kansas-Nebraska Natural Gas Company (City of Detroit)*, 25 F.P.C. 448 (1964),[22]

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[19] "*We cannot strike down an act of Congress if we think it unwise, or unnecessary to a particular industry, and enforce it only if it is in accord with our economic and regulatory philosophy.* It is undisputed that Section 167 of the Internal Revenue Code does apply, and was intended to apply to regulated natural gas companies, such as the petitioners.

"The extraordinary ability and willingness of natural gas companies, including petitioners, to attract capital and construct new facilities causes us to question whether the incentive provided by section 167 of the Internal Revenue Code is necessary or desirable for this industry or will, in the long run, be as beneficial to the public interest *as is the present, traditional method of treating depreciation expense.*

"We are calling this situation to the attention of the Congress by transmitting copies of the presiding examiner's decision, our opinion herein, and the dissenting opinion attached hereto, to the chairman of the Finance Committee of the Senate and the chairman of the Ways and Means Committee of the House." (15 F.P.C. at 782; emphasis supplied.)

[20] El Paso Natural Gas Co. v. F.P.C., 5 Cir. 1960, 281 F. 2d 567, cert. denied, *sub nom.* California v. F.P.C., 366 U.S. 912.

[21] Review was not sought.

[22] City of Detroit v. F.P.C., D.C. Cir. 1955, 230 F. 2d 810, cert. denied, 352 U.S. 829.

in a Section 168 case, the Commission gave its blessings to use of tax deferrals for income-producing purposes. Shortly after this decision, the Commission applied the 1.5 per cent return to accumulated tax deferrals of *Panhandle Eastern Pipe Line Company,* 25 F.P.C. 550 (1961).[23]

When these cases reached court review, the courts accepted the Commission's policy of allowing normalization as an informed judgment within the special competency of a regulatory agency. Without exception, however, the courts put the Commission and the natural gas industry on notice that for ratemaking purposes Section 167 was not a congressional mandate to regulatory agencies to approve normalization.

In *El Paso Natural Gas Company,* 5 Cir. 1960, 281 F. 2d 567, cert. denied *sub nom, California* v. *Federal Power Commission,* 1961, 366 U.S. 912, this Court affirmed the Commission's approval of normalization of taxes. But we rejected the notion that normalization is necessary to effectuate the congressional objective expressed in Section 167. Speaking for the court, Judge Tuttle said:

> "* * * The requirement that the Commission determine a just and reasonable rate is not modified by reading into the [Natural Gas Act] an exception to the extent that the prices charged may be sufficient to afford a just and reasonable rate *plus* an amount representing a savings in taxes granted to the gas industry. *We think there is nothing in the legislative history that would warrant our concluding that Congress intended the statutory depletion, deduction of intangible drilling expe[illegible], and rapid depreciation provisions of the Revenue laws to amend or modify the express language of the Natural Gas Act* * * *" 281 F. 2d at 572.

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[23] Panhandle Eastern Pipe Line Co. v. F.P.C., D.C. Cir. 1963, 316 F. 2d 659.

Continuing, this Court observed that "there is no statutory authority for the Commission to treat actual savings in taxes to which natural gas companies are entitled any differently from savings in any other cost of service. . . . Such savings as are effected are passed on to the consuming public." 281 F. 2d at 573. In discussing the depletion allowance we made it clear that tax benefits need not be translated into additional profits over and above a reasonable return on the utility's investment. We emphasized that tax benefits "are available to the regulated companies to make it so much the easier for them, in competition with other industries seeking the investor's dollar to earn a fair return, including the substantial increment of incentive for exploration and development and payment for gas consumed." 281 F. 2d at 571. This analysis applies equally to the tax benefits of rapid depreciation. Full effect must be given to the congressional purpose to make depreciation options available to the petitioner; but the specific incentives provided by the Internal Revenue Code must be reconciled with the general scheme of regulation of gas pipelines under the Natural Gas Act.

Before this Court decided *El Paso Natural Gas Company* the Commission ruled on another Section 167 case, *United Fuel Gas Company*, 23 F.P.C. 127, 512 (1960). When this case reached the Fourth Circuit, as *Cities of Lexington* v. *Federal Power Commission*, 4 Cir. 1961, 295 F. 2d 109, the Court noted that there were competing theories as to the rate treatment of liberalized depreciation at both federal and state levels. The Fourth Circuit, like the Fifth Circuit, affirmed the Commission's adoption of normalization, not as required by a congressional mandate but as a matter within the FPC's regulatory discretion under the Natural Gas Act:

> "It is obvious that we are confronted in this case with a problem in a special field which requires the exercise of expert skill that has been generally entrusted by state and Federal legislation to administrative regula-

tory tribunals whose decisions, in the absence of abuse of discretion, should be followed by the courts. We adopt that course in this case." 295 F. 2d at 114.

The District of Columbia Court of Appeals agreed with the Fourth and Fifth Circuits. In *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, D.C. Cir. 1963, 316 F. 2d 659, cert. denied, 375 U.S. 881, the Court held that the rate of return permitted utilities on reserve funds accumulated under the prior rule of normalization was within the expert competence of the Commission, but made it quite clear that nothing in Section 167 dictated the regulatory treatment of liberalized depreciation.[24] The Court said:

"We now briefly consider the policy underlying § 167 of the tax statute. *Nothing in the language or legislative history indicates that Congress considered its regulatory consequences.* Thus, to infer that the statute materially altered fundamental principles of state regulation—which require rates to reflect actual costs of capital—it must clearly appear that Congress intended to benefit producers to the exclusion of consumers. It does not so appear: the legislative history reveals that Congress intended the statute 'to have far reaching economic effects' extending to 'all segments of the American economy'. Liberalized depreciation was seen as a means toward a broad economic goal; it was expected to 'assist modernization and expansion

[24] In City of Detroit v. F.P.C., D.C. Cir. 1955, 230 F. 2d 810, the court held that the intent of Congress in enacting what is now section 168 of the Internal Revenue Code (Amortization of Emergency Facilities) was to benefit taxpaying producers and not their consumers. In *Panhandle Eastern Pipe Line* the court limited its City of Detroit holding: "We are not constrained to read the case as deciding that in all circumstances and in the light of greater experience with the operation of § 167 the greatest possible benefit should inure to the producer and none at all permitted to the consumer." 316 F. 2d at 662, n. 4.

of industrial capacity, with resulting economic growth, increased production, and a higher standard of living.'" 316 F. 2d at 662.

In short, as the Commission accurately stated in its brief: *El Paso Natural Gas Company* (and other cases) "purged [the Federal Power Commission] of the erroneous legal view which it had previously believed compelled a contrary result" and "freed the Commission's hand to make the instant reevaluation of the problem."

C. *Legislative History.* The legislative history of Section 167 is as unmalleable as granite. With great diligence, however, counsel for both parties, amici, and this Court labor to prove the truth of Chief Justice Marshall's axiom: "Where the mind labors to discover the design of the legislature, it seizes everything from which aid can be derived." *United States* v. *Fisher,* 1805, 6 U.S. (2 Cranch) 358, 386.

For purposes of this case, as we see it, the most important fact in the legislative history of Section 167 is the long reach of the National Gas Act. Congress might have reduced that reach through the expedient of a statutory direction requiring the regulatory agencies to allow taxpayers to retain all the economic benefits of liberalized depreciation. However, in view of the extensive regulatory scheme entrusted to the Federal Power Commission and to other federal regulatory agencies, one would expect Congress to speak out loud if it had intended Section 167 as a limitation on agency ratemaking powers. In the absence therefore of clear congressional directives with regard to ratemaking, the Commission was within the statutory purposes in giving effect to Section 167 only to the extent that is appropriate within the principles established in the Natural Gas Act.

The central principle in the regulation of the natural gas industry around which all ratemaking revolves is

"the intention of Congress that natural gas shall be sold in interstate commerce for resale for ultimate

public consumption . . . at the lowest possible reasonable rate consistent with the maintenance of adequate service on the public interest."

This is the language of Section 7(c) of the Natural Gas Act as originally enacted in 1938. The provision was deleted when the subsection was amended in 1942 but, as the Supreme Court has held, the amendment was not intended to change the congressional purpose of the Act; the "primary aim of this legislation was to protect consumers against exploitation at the hands of natural gas companies." *Federal Power Commission* v. *Hope Natural Gas Company*, 1944, 320 U.S. 591, 611, 64 S. Ct. 281, 88 L. Ed. 333. Again, as Justice Douglas reiterated twenty-five years later: "The act was so framed as to afford consumers a complete, permanent, and effective bond of protection from excessive rates and charges." *Atlantic Refining Company* v. *Public Service Commission*, 1959, 360 U.S. 378, 388, 79 S. Ct. 1246, 3 L. Ed. 2d 1312.

The fixing of "just and reasonable rates" is the heart of the regulatory system, including specifically the power to investigate and ascertain the "actual legitimate cost" of property. Natural Gas Act § 6(a), 15 U.S.C. § 717e(a); *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. at 591. The Commission is not bound to use any single formula or combination of formulae in determining rates; its ratemaking function involves the making of "pragmatic adjustments." *Federal Power Commission* v. *Natural Gas Pipeline Co.*, 1942, 315 U.S. 575, 62 S. Ct. 736, 86 L. Ed. 1037. "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end. The fact that the method employed to reach that result may contain infirmities is not then important. . . . It is the product of expert judgment which carries a presumption of validity." *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. at 602. Since Congress has expressly delegated to the

Commission discretionary power to regulate rates in the natural gas industry, Section 167 could operate as a limitation on the Commission only to the extent that exercise of the option to use liberalized depreciation does not interfere with the FPC's duty to fix "just and reasonable rates." It is at least a fair construction of the general statutory purposes and the legislative silence on the concrete situation before us that Congress did *not* intend to fetter administrative discretion to the point where the Commission would be powerless to prevent a regulated company using Section 167 as an excuse to charge excessive rates.

There is no evidence that at the time Section 167 was enacted Congress even focused on the problem in terms of reducing the dimensions of the Federal Power Commission's regulatory responsibility to protect consumers from excessive rates.[25] The general rule of Section 167, as of its 1939 Code predecessor, is that the taxpayer be accorded "a reasonable allowance" for depreciation. The effect of the section is to include as a "reasonable allowance"

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[25] In a recent comment, Liberalized Depreciation: About-Face by the FPC, 50 Va. L. Rev. 298, 320, 325 (1964), the author reached the conclusion that the Commission's decision in the instant case is "in conflict" with the intent of Congress. The author effectively demonstrates that the legislative history of Section 167 shows "an intent to stimulate the economy by, in effect, placing extra working capital in the hands of producers. He concedes however that "there is very little which helps answer the question of what application this section was to have in the field of public utility ratemaking"; but nothing in the reports or the debates indicates that section 167 was not intended to apply to public utilities. See also, in accord, Flittie and Armour, The Natural Gas Experience—A Study in Regulatory Aggression and Congressional Failure to Control the Legislative Process, 19 Sw. L.J. 448, 495-99 (1965). On the other hand, another commentator has concluded that "the issue is not clarified by a debate as to whether or not Congress intended that these benefits be retained by regulated utilities"; that "the legislative history of Section 167 of the Code is specific only in evincing a congressional purpose to defer rather than to excuse the payment of taxes." Swiren, Accelerated Tax Benefits in Utility Rate Making, 28 U. Chi. L. Rev. 628, 631 (1961).

several specific forms of rapid depreciation, including but not limited to the straight-line, declining balance, and sum of the years-digits methods. The stated purpose is to "increase available working capital and materially aid growing businesses in the financing of their expansion." S. Rep. No. 1622, 83d Cong., 2d Sess. 26 (1954). Congress expected liberalized depreciation to "assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of living." Ibid. Rapid depreciation is not made compulsory; it remains elective. Straight-line depreciation is expressly approved as an alternative, and provision is made for transfer to the straight-line method at any time by the taxpayer.[26] The House Report declares that the liberalization would "merely affect the timing and not the ultimate amount of depreciation deductions with respect to *a property.*" H.R. Rep. No. 1337, 83d Cong., 2d Sess. 25 (1954) (Emphasis added). Both the President and Congress emphasized that the incentive provided in Section 167 was a postponement of federal income taxes. There is not the slightest indication of a suggestion of providing permanent tax savings. The Commission's finding in this case, therefore, that the use of liberalized depreciation resulted in "true savings" to Alabama-Tennessee for the "foreseeable future" is critical. To permit such savings would be inconsistent with the statements frequently made in the floor debates and in the committee reports that the section was not intended to affect the total deductions.

There is nothing in any of the committee reports showing that Congress considered "the ultimate amount of depreciation deductions" with respect to the *total* depreciable property of a utility. And, although rapid depreciation increases available working capital in the business community generally, there is no evidence of a congressional purpose to override the Commission's *ad hoc* power to tailor a utility's return to the facts of the individual case,

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[26] Int. Rev. Code § 167(e) (1954).

consistent with the capital costs and financial integrity of the enterprise. Congress made the tax benefit available; it is for the Commission to regulate the availability of this benefit for working capital in each case by adjustment of the rate of return.

Legislative silence is a Delphic divination. The petitioner argues that ever since the 1954 Revenue Code was adopted Congress has been well aware of the FPC's policy of allowing normalization and that its inaction indicates approval of that policy.[27] By the same token, the Commission argues that Congress has been well aware of the lack of uniformity that has evolved among federal agencies as to the disposition of increased depreciation allowances under the revenue laws; that congressional inaction indicates approval of a discretionary authority in the regulatory agencies. The Civil Aeronautics Board and the Securities and Exchange Commission still permit normalization. On the other hand, the Interstate Commerce Commission has ordered flow-through *to income* since 1959. Accounting for Federal Income Taxes, Interstate Commerce Commission Notice, February 9, 1959, Fed. Carr. Rep. ¶ 23,086. The Interstate Commerce Commission even requires flow-

[27] In 1957, H.R. 5824 and S. 2113 were introduced in Congress. These bills provided that the Commission could not include tax deferrals arising as a result of Sections 167 and 168 of the Internal Revenue Code of 1954 in the determination of the rates of electric public utilities subject to the Federal Power Act. Both bills failed to pass. On September 2, 1958 Congress amended Section 167. No change was made in that Section to indicate that the Commission had misinterpreted the intent of Congress in its treatment of liberalized depreciation in carrying out its functions under the Natural Gas Act. The question of regulatory treatment of Sections 167 and 168 of the Revenue Code were the subject of an investigation and hearings in Congress. See "Rapid Amortization in Regulated Industries, Report of the Committee on the Judiciary, United States Senate, Subcommittee on Antitrust and Monopoly," Report No. 1380, 88th Congress, 2d Sess., March 12, 1958. At this time the Commission permitted normalization under Sections 167 and 168.

through of accelerated depreciation for the same carriers granted the benefit of the entire 7 per cent investment credit in the Revenue Act of 1964.

In the Revenue Acts of 1962 and 1964 Congress demonstrated that when it desires a tax statute to restrict the ratemaking authority of federal regulatory agencies it does so in precise language. In the text of the 1964 Revenue Act Congress expressly provided that federal regulatory agencies shall not use the taxpayer's investment credit under Section 38 of the Internal Revenue Code for a given year to reduce the federal income tax component of cost of service, as had been proposed by the Federal Power Commission.[28]

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[28] For the purpose of the investment credit, public utility property is taken into account as a "qualified investment" at 3/7 of the amount otherwise allowable. Int. Rev. Code § 46(c)(3)(A), added by Section 2(b) of the Revenue Act of 1962. See Treas. Regs. § 1.46-3(g)(1) (1964). Section 46 provides that the amount of credit for all other taxpayers will be seven per cent of the investment. Other taxpayers include other regulated companies—such as *natural gas pipelines,* railroads, airlines, truck and bus operators, and other types of public carriers. H.R. Rep. No. 749, 88th Cong., 2d Sess. (1963), 1964-1 (II) Cum. Bull. 162. Congress provided the 3 per cent credit for public utility property rather than 7 per cent since it was recognized that in this case part of the investment credit expected any larger credit probably would be passed on to the customers in lower rates. *Id.*, 1964-1 (II) Cum. Bull. 163.

Different treatment of the investment credit and rapid depreciation seems justified by the nature of the two types of tax benefits. The Senate Report on the Revenue Act of 1962 distinguishes liberalized depreciation from the investment credit:

> "Realistic depreciation alone . . . is not enough to provide the essential economic growth. In addition, a *specific incentive* must be provided if a higher rate of growth is to be achieved." S. Rep. No. 1881, 87th Cong., 2d Sess. 11 (1962) (Emphasis added).

The Committee added that the credit was preferable to the alternative of higher depreciation charges because, "the latter tend to distort income accounting and produce higher costs for book purposes." *Id.* at 12.

The Conference Report on the 1962 Revenue Act states that the investment credit purpose "in the case of *both* regulated and non-regulated industries, is to encourage modernization and expansion of the Nation's productive facilities and to improve its economic potential by reducing the net cost of acquiring new equipment, thereby increasing the earnings of the new facilities over their productive lives." H.R. Rep. No. 2508, 87th Cong., 2d Sess. 14 (1962) (Emphasis added). Despite this reference by the conferees to regulated industries, the Federal Communications Commission and the Federal Power Commission indicated that the Section 38 benefits should flow through immediately to customers. Congress considered this view to be "clearly contrary to the intent of Congress" and, as a result, included in the 1964 Revenue Act a provision "reasserting its position that it was not . . . its intention that the Federal regulatory agencies require the benefit of the investment credit to 'flow through' in this manner." H.R. Rep. No. 749, 88th Cong., 1st Sess. 37 (1963); Revenue Act of 1964 § 203(e). In expressly preserving the investment credit benefit for regulated industries, Congress again noted that the objective of the credit "is *to reduce the net cost* of acquiring new equipment, thereby increasing the earnings of the new facilities over their productive lives." Id. at 12. The credit is not a deduction from income as is depreciation under Section 167; it is a direct deduction from the tax payable. Congress has shown an inclination to set different rates of investment credit for different industries—the equivalent of 3 per cent for public utilities and 7 per cent for others. The investment credit is a precisely computed benefit specifically awarded to reduce net costs, and is therefore distinguishable from the traditional deduction for reasonable depreciation.

The petitioner underscores the fact that the Commission itself alerted Congress to the problem. Thus the Commission transmitted the *Amere* decision to Congress and point-

edly noted its regulatory interpretation and practice in its annual reports to Congress;[29] Congress still refused to enact legislation precluding the FPC from authorizing normalization under Section 167.[30] The Commission, on the other hand, points to Amendment No. 350 of the Revenue Act of 1964 (H.R. 8363, 88th Cong., 1st Sess., December 9, 1963). This bill expressly provided that federal regulatory agencies, for rate purposes, normalize federal income taxes with respect to Section 167 liberalized depreciation deductions and permit a full return on the capital thus generated. Although federal agencies were following opposite and irreconciliable courses in their treatment of liberalized depreciation and although failure to enact the amendment would result in different treatment for investment credit, Congress declined to enact the amendment.[31]

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[29] FPC Ann. Rep. 75 (1956); FPC Ann. Rep. 75 (1957). See also S. Rep. No. 1380, 85th Cong., 2d Sess. 3-6 (1958).

[30] See H.R. 5824, 85th Cong., 1st Sess. (1957); S. 2113, 85th Cong., 1st Sess. (1957). Section 168 was amended. Int. Rev. Code of 1954, §§ 1168(e)(1), (e)(2), (e)(4), and (i). A Senate subcommittee report commented on the FPC's treatment of Section 168 as "a surprising disclosure" and took the position that rapid depreciation under Section 168 was inappropriate for public utilities because they were guaranteed a return. S. Rep. 1380, 85th Cong., 2d Sess. 3-6 (1958). Senator Byrd, Chairman of the Senate Finance Committee, in a hearing on Section 168, said: There "is no justification whatever for a power utility to get a rapid tax depreciation. They are guaranteed profits. . . ." Hearings on S. 1795 Before the Senate Comm. on Finance, 85th Cong., 1st Sess. 9 (1957).

[31] The bill was considered and rejected by the Senate Finance Committee and did not come to a vote on the floor. Press Release No. 20, Senate Finance Committee, Jan. 21, 1964. Flow-through of the investment credit itself did not pass without dissent. See S. Rep. No. 830, 88th Cong., 2d Sess. (1964), 1964-1 (II) Cum. Bull. 672, 694-96 (individual views of Sen. Ribicoff; minority views of Sen. Gore).

Of course, as far as possible the FPC should give effect to the Natural Gas Act and to Section 167.[32] To the extent it is impossible to accommodate both statutes, customary canons of statutory interpretation give controlling effect to the specific statute over the general statute.[33] Such canons are of no help in this case. The Commission contends that Natural Gas Act deals specifically with the regulation of rates in the natural gas industry; the Revenue Code of 1954 deals generally with the taxation of all industries. The petitioner contends that the specific provision in Section 167 for liberalized depreciation as a means of providing an incentive to plant expansion should prevail over general ratemaking authority.

Occam's razor slices through the arguments based on legislative history and congressional intent. Either Congress did not consider the concrete problem this case presents or, if it did, Congress decided to let sleeping dogs lie. In these circumstances, we turn to Judge Learned Hand's resolute advice. "Flinch as we may, what we do, and must do is to project ourselves, as best we can, into the position of those who uttered the words, and to impute to them how they would have dealt with the concrete occasion." *United States* v. *Klinger*, 2 Cir. 1952, 199 F. 2d 645.

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[32] The Commission's decision in *Panhandle Eastern* to allow a return of 1.5 on the deferred reserves was an effort to accommodate Section 167 to the Natural Gas Act.

[33] In Panama Canal Company v. Anderson, 5 Cir. 1963, 312 F. 2d 98, 100, cert. denied, 375 U.S. 832, this Court said: ". . . If there is any repugnancy between them the specific or particular statute will control over and supersede a general statute even though the general measure be more recently enacted. Sutherland, Statutory Construction 3rd Ed. 541, § 5204, 82 C.J.S. Statutes § 369, p. 839; Bulova Watch Company v. United States, 365 U.S. 753, 81 S. Ct. 864, 6 L. Ed. 2d 72; Enzor v. United States, 5 Cir. 1959, 262 F. 2d 172, cert. den. 359 U.S. 953, 79 S. Ct. 740, 3 L. Ed. 2d 761; Price v. United States, 5 Cir. 1934, 74 F. 2d 120, cert. den. 294 U.S. 720, 55 S. Ct. 549, 79 L. Ed. 1252, reh. den. 295 U.S. 767, 55 S. Ct. 643, 79 L. Ed. 1708."

Given the long reach of the Natural Gas Act, as liberally interpreted by the Supreme Court, and weighing the consumer-oriented objectives of that Act against the Section 167 objective of promoting plant expansion by postponing the timing of tax payments, we conclude: It is unlikely to suppose that Congress amended the Natural Gas Act by a reference in the Internal Revenue Code; it is unreasonable to read Section 167 as a mandate reducing the Commission's responsibility to fix fair rates according to its usual ratemaking policies in favor of the consumer. At bottom, the question before us was and is one for Congress to decide. Assuming that Congress considered the effect of Section 167 on ratemaking at the time of enactment or later, we infer that its decision not to disturb, in terms, the status quo of ratemaking indicates a congressional intent that each federal regulatory agency should continue to exercise an informed discretionary authority in accordance with the agency's usual standards in the light of the needs peculiar to the particular industry subject to rate regulation.[34]

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[34] When the California Public Utilities Commission sought review of this court's decision in *El Paso* in the Supreme Court, the Solicitor General of the United States, correctly we think, opposed the granting of certiorari on the ground that the case presented only a matter of administrative discretion:

> "... From this survey, it appears that, whatever merit there may be in either method, the least that can be said is that a regulatory commission's choice between the two [normalization or flow-through] is assuredly within its discretion, depending on the particular views of the particular agency. No *general issue of law is involved,* only a discretionary choice among competing accounting systems. Such a choice is not one which warrants review by this Court. *Under the same principle, the choice is one which can be changed by the Commission should it become convinced that the other method is preferable.* Such a change can be made without disturbing the requirement that reserves already accumulated be used only for the originally intended consumers' benefit." (Brief for the Federal Power Commission in Opposition, California v. FPC, No. 599, U. S. Supreme Court, pp. 11-12 (1961); emphasis supplied.)

D. *Tax Savings from Normalization.* For any given tax year, a utility's depreciable properties include assets of various ages. Consequently, so the Commission found, "below normal" depreciation on older assets is counterbalanced by "above normal" depreciation on new assets as long as the company continues the use of liberalized depreciation and continues to make at least some capital additions. Under these conditions, liberalized tax depreciation will always exceed straight-line tax depreciation and the accumulations established under the normalized rate and deferred tax accounting will continue to increase until the dollar value of gross plant stabilizes. Even if the composite plant of a company remains stable, where the dollar value of retirements equals the cost of replacements, annual liberalized depreciation will not be lower than straight-line depreciation and the reserve established under normalization will not decline.[35]

A regulated utility, therefore, will *never* be required to pay higher income taxes because of its election to claim liberalized depreciation *unless* its gross plant declines in dollar value as a result of lower demand or lower plant construction cost. Normalization during a period of growth or stability would force the ratepayers to provide funds for a hypothetical tax liability that might never become payable or, at the very least, to provide funds many years in advance of the time they are needed. The Commission's records show that the deferred tax accounts of Alabama-

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[35] The Commission cites the National Association of Railroad and Utilities Commissioners, Report of 67th Annual Convention (1955); Eisner, Depreciation Under the New Tax Law, 33 Harv. Bus. Rev. 66-74 (1955); Davidson, Accelerated Depreciation and the Allocation of Income Taxes, 33 Accounting Rev. 173 (1958); and two arithmetic charts presented by the Secretary of the Treasury to the Senate Finance Committee in connection with the Revenue Act of 1962 (Hearings on H. R. 10650, 87th Cong., 2d Sess., Part 1, p. 384).

Tennessee and other pipeline companies have increased substantially since the accelerated depreciation election became available.

Petitioner argues that under Section 167, liberalized depreciation is applied to facilities constructed during the period covered by the tax return and it is necessary that the taxpayer maintain the identity of individual units of property in order to know what deductions may be made each year for depreciation. Moreover, the Commission's Uniform System of Accounts requires this. That the reserve for deferred taxes may continue to increase for an indefinite period the petitioner deems of no consequence. The petitioner would hold the Commission, in its ratemaking process to the same computation of depreciation on specific assets as required by the Internal Revenue Service under Section 167 for tax accounting. It would have the Commission disregard the cumulative reserve for accelerated depreciation for the utility's total assets. The Commission's error, according to petitioner, is that it refuses to recognize the mechanics of determining the taxes to be paid. The short answer is that accounting for tax purposes and even the Commission's present Uniform System of Accounts may be valuable tools, but they cannot dictate ratemaking policies. *Cf. American Tel. & Tel. Co.* v. *United States,* 1936, 299 U.S. 232, 57 S. Ct. 170, 81 L. Ed. 142.

To support its ruling that the level of future expenditures for Alabama-Tennessee's operating plant will continue to increase or at least remain stable in the foreseeable future the Commission relied on records of the past and estimates of future growth of Alabama-Tennessee and of the natural gas pipeline industry. Alabama-Tennessee's annual reports on file with the Commission show an increase in sales from 9,504,752 Mcf in 1954 to 20,807,306 Mcf in 1962; an increase in net plant from $4,069,260 to

$6,119,349.[36] Its investment in plant facilities shows corresponding growth. The intervenor's expert witness, Van Scoyoc, testified that natural gas pipelines may expect to continue their growth indefinitely.[37] From 1954 to 1960,

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Gas Utility Plant[1]
Alabama-Tennessee Natural Gas Company

Year	Gross	Reserve for Depreciation	Net Plant
1949	$1,898,997	$ 2,353	$1,896,643
1950	3,315,222	77,792	3,237,429
1951	3,902,816	189,409	3,713,406
1952	4,059,345	318,936	3,740,408
1953	4,336,119	460,426	3,875,692
1954	4,655,459	586,198	4,069,260
1955	5,329,314	667,222	4,662,091
1956	5,423,710	815,325	4,608,384
1957	5,822,075	994,438	4,827,636
1958	6,226,161	1,186,563	5,039,597
1959	6,591,323	1,376,576	5,214,746
1960	7,151,489	1,590,767	5,560,722
1961	7,439,954	1,773,348	5,666,606
1962	8,031,865	1,912,515	6,119,349
1963	9,017,273	2,144,175	6,873,099

[1] Figures are taken from the Federal Power Commission's annual publication, Statistics of Natural Gas Companies.

[37]

Gas Utility Plant[1]
Natural Gas Pipeline Companies
In Thousands

Year	Gross Plant	Reserve for Depreciation	Net Plant
1954	$5,220,166	$1,003,082	$4,217,084
1955	5,692,265	1,161,629	4,530,636
1956	6,303,435	3,284,953	5,018,482
1957	7,359,854	1,491,217	5,868,637
1958	8,034,344	1,688,157	6,346,187
1959	8,973,860	1,973,078	7,000,782
1960	9,938,047	2,259,407	7,678,640
1961[2]	10,196,307	2,528,045	7,668,262
1962	10,963,623	2,839,385	8,124,238
1963	11,336,764	3,105,929	8,230,835

[1] Figures are taken from the Federal Power Commission's annual publication, Statistics of Natural Gas Companies.

[2] In 1961 there was a reclassification of companies formerly reported as "natural gas pipeline companies." In addition other

natural gas pipelines increased their gross plant by an average of 11.07 per cent. During this same period, electric utilities increased their gross plant at the smaller annual rate of 8.38 per cent. Furthermore, the Commission found that, at least until 1980, nearly all responsible forecasts indicate a continued expansion of the gas pipeline industry.[38]

Alabama-Tennessee and amici supporting the petitioner argue persuasively that the Commission fails to give ade-

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adjustments were made to the Commission plant accounts. Thus the figures prior to 1961 are not comparable to those for 1961, 1962, and 1963. The figures for the latter three years show however, that pipeline companies have continued to expand their facilities.

[38] The forecasts of continued expansion relied upon by the Commission include: Report of the National Fuels and Energy Study Group to the Committee on Interior and Insular Affairs, 87th Cong., 2d Sess. (1962); Bureau of Statistics, American Gas Association, Projected Gas Utility and Pipeline Industry Statistics, 1963-1972 (1963).

The Report of the National Fuels and Energy Study Group, upon which the Commission placed reliance, concluded with respect to future gas consumption (p. 37):

> A range between 20 trillion cubic feet and 23 trillion cubic feet to be used in 1980 seems to satisfy the expectations of most of the estimators as determined by the margin-of-error concept. This would represent an increase of between seven-tenths and nine-tenths over consumption in 1960. • • •
>
> For the purpose of this study it is concluded, then, that the use of gas in 1980 will be somewhat less than double the 1960 usage—that the use of gas will increase somewhat more slowly than will the use of coal or total energy.

The forecast by the Bureau of Statistics of the American Gas Association estimated that gross plant for the gas utility and pipeline industry will increase from 24.7 billion dollars in 1962 to 42.5 billion dollars in 1972. These forecasts were based on estimates submitted by individual gas companies.

quate consideration to future risks.[39] In the depression the public utility industry was the victim of misguided theories of depreciation and retirement reserve accounting. The petitioner insists that it cannot be assumed that the cash requirements in the future to pay deferred tax expenses will be offset by other items of tax deduction from other properties. The basic reality is that taxes deferred must be paid in the future; the permanence of de-

[39] In a notable opinion, Judge Schaefer, for the Illinois Supreme Court, said: "The assumption of a continuous deferral of taxes due to accelerated depreciation may be justified in many cases and the Commission would be justified in acting on this assumption if it saw fit. [citations omitted] Experience may show that proper results can only be achieved by this approach. However, several not unlikely events might occur which would prove the assumption erroneous. A war, a general depression or a decline in the local market might curtail a utility's capital expenditures, and prevent further tax deferrals. As a result, taxes might increase just at the time when economic circumstances would make the added expense most burdensome. It is also possible that section 167 will be repealed, thus ending further tax deferrals.

If we could see clearly into the future and say with certainty that continuing expansion was certain, and countervailing considerations were nonexistent, we would hold that the Commission may not permit current charges for a liability that will never arise. Predictions of future developments, however, are unsure estimates at best. The problem is a new one; that factual and policy considerations that bear upon its solution have not as yet been fully developed. Even the future of accelerated depreciation in the Federal tax structure is not entirely settled. If for any reason continued investment in utility plant at current levels should cease, or accelerated depreciation be denied, the financial stability of utilities might be jeopardized if some provision had not been made for the increased taxes that would result. Rate regulation is a continuing process; greater experience may bring greater wisdom in dealing with these problems. At this time, we think it permissible for the Commission to safeguard the financial integrity of utilities by recognizing as present expenses those tax liabilities which are deferred by use of accelerated depreciation for Federal tax purposes." City of Alton v. Commerce Commission, 1960, 19 Ill. 2d 76, 165 N.E. 2d 513, 521.

ferrals or the equation of deferrals with savings is an illusion; deferred accounting is a necessity in order to meet future increases in taxes. Flow-through, so petitioner asserts, must necessarily have an adverse effect upon the financial standing and credit. And an overhanging burden of unfunded deferred taxes imposes additional risks which will be reflected in the cost of equity and debt-financing.

It is true that the Commission's decision rests on its reading of the future. But clairvoyance is part of the daily grind of a regulatory agency. Whether flow-through or normalization is the rule, the agency must base the rule on some projection into the future. As we see it, the case for normalization requires more speculation than the case for flow-through. And it is at the expense of consumers.

On the record before us and the facts outside of the record which the Commission properly notices, the Commission's ruling is based on substantial evidence of present conditions and a fair guess as to future conditions in the pipeline industry. If the Commission is wrong, the pipelines will still have paid only actual taxes; these will be recouped in full as part of the cost of service. Besides, as a hedge against the risk of a "payback," the Commission has allowed Alabama-Tennessee to retain tax reserves accumulated since 1954.[40] Should the future support

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[40] In a similar situation the Illinois Supreme Court set aside an order of the Commerce Commission allowing a water company an operating deduction for deferred taxes without making an offsetting deduction in the determination of the rate base. The court accepted the principle of normalization both for accounting and for ratemaking but required the excess in tax allowances over actual taxes to be credited to a special reserve, the amount of this reserve being deducted from cost-new in arriving at the rate base. City of Alton v. Commerce Commission, *supra* note 39. Judge Schaefer, for the court, said: "Funds generated by accruing

the Commission's competency in clairvoyance and should normalization be allowed, consumers will have made enormous contributions to the pipelines' capital funds at no cost to the pipelines. The Commission must, of course, concern itself with the possibility of having misread the future and with the future's taking a turn without benefit of advice from the Commission. All things change. But we should expect agency policy to be sufficiently flexible to attempt to change with changing times. Sufficient unto the day is the evil thereof.

In final analysis, putting to one side the issue of congressional intent, the petitioner's challenge to the FPC order addresses itself to the competency of the Commission to choose between competing accounting theories and competing economic guesses. We see nothing irrational in the Commission's choice.

E. *Miscellaneous Attack on Order.* Petitioner attacks the Commission's finding that flow-through will stimulate investment. The Commission believes that lower rates will tend to generate a higher volume of sales and thus ultimately require expansion of gas transmission facilities. The Commission found that in the past two decades pipelines have financed a tremendous expansion, at a cost of over $9 billion, and there is no indication that they will have any problem financing the more moderate expansion expected in the near future. As for Alabama-Tennessee, the Commission found that the petitioner has

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deferred tax expenses, and any facilities financed out of those funds, must be excluded from the rate base. The earning power of this money then will either decrease consumer rates or increase service. The economic benefit to consumers over the life of any given asset should be about the same as if no accrual of deferred tax expenses were allowed, but it will be spread evenly over the useful life of the asset rather than being concentrated in the early years when depreciation rates for tax purposes are above normal." 165 N.E. 2d at 522.

achieved a "favorable position in the eye of the investor" and an "ability to finance successfully."[41]

The amicus brief of Arthur Andersen & Co. attempts to show that if normalizaiton is followed and no return is allowed that consumers would pay one tenth of one per cent *lower* rates than if flow-through is required. This contention, however, makes no allowance to consumers for loss of interest on the accumulated tax reserve. If interest costs on the accumulated tax reserves are included, the consumers bear a greater cost over the years under normalization that flow-through. In addition, exercising its special competency, the Commission determined that Andersen's assumptions of plant life and other matters were unrealistic and unrelated to Alabama-Tennessee or to the industry.

Alabama-Tennessee states that to minimize the risk of future contingent liability for taxes it will be forced to give up the use of liberalized depreciation. May 5, 1964, Alabama-Tennessee advised the Commission of this intention. The Commission indicated its approval of petitioner's accounting entries to reflect the election to use straight-line depreciation after January 1, 1963, but stated that this approval "should not, however, be deemed as any prejudgment of the rate treatment to be given such action."[42] Later the Commission informed Alabama-Tennessee that this issue "could be litigated only in a new Section 4 proceeding to be instituted by petitioner if it desires to convert to straight-line depreciation taxes and such conversion results in a net increase of cost of service over that in 1960, the base period in this case."[43] Since the Commission has not yet ruled on petitioner's application for conversion to straight-line tax deprecia-

[41] See footnote 36.

[42] FPC's answer to petitioner's motion for stay for this appeal.

[43] FPC's answer to motion for stay of order.

tion, the effect of the proposed conversion is not a proper subject for review in this case.[44]

The petitioner asserts that the Commission erred in denying any return upon tax deferrals already accrued, by including them at zero cost in computing Alabama-Tennessee's overall rate of return.[45] The Commission's view is that Alabama-Tennessee and other pipeline companies should be given the option of retaining the accumulations as reserves or of amortizing them over a period of years by refunds or rate reductions under a submitted plan. This view is consistent with the Commission's finding that no cost has been incurred in the accumulation of these balances.

The petitioner sets forth the same arguments against denial of return on the accrued funds as against denial

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[44] The Commission was careful to say that the decision was not to be taken as indicating any views on the question whether a company that does not elect to compute its taxes on the liberalized depreciation method should have its rates fixed as though it did. The Commission observed that the decision involved no re-examination of policy with respect to accelerated amortization under Section 168 of the Internal Revenue Code. 31 F.P.C. at 210.

The Commission has instituted a proceeding under Section 5 of the Natural Gas Act "for the purpose of implementing the regulatory policies determined and established" in the opinions under review here. FPC Docket No. R-264, July 7, 1964, 29 Fed. Reg. 9723.

[45] The Commission had inadvertently included the reserves at zero cost in Opinion No. 360, which was intended to dispose only of all other issues in the cases involved in this proceeding. This error was recognized in Opinion No. 417-A, but the Commission ratified the error on the basis of its adoption of the flow-through principle. The Commission asserts that including the tax reserves at zero cost reaches the same result as deducting the reserves from Alabama-Tennessee's rate base. Although petitioner rejects the basic principle of zero return on the past tax accruals, it does not protest the Commission's method for excluding the reserves from the rate base.

of normalization. We find that the Commission's decision not to allow a return on accumulated deferred tax balances is supported by essentially the same evidence as its decision to adopt flow-through. It is improbable, so the Commission found, that these accumulated tax balances will be needed for future tax liability. They have become consumer-contributed capital without specific purpose. The consumer already suffers the loss of interest on these funds. This being the case, it would be further anomaly for the consumer to pay the pipelines a return on the capital. Rate of return on capital, like the flow-through question, must be left within the sound discretion of the Commission.

We have considered all of the contentions of the petitioner and the amici and have considered carefully certain contentions not discussed in depth in this opinion. We find substantial evidence and fair inferences supporting the Commission's finding that there is no justification, on the facts here presented, for including in the petitioner's cost of service an allowance for taxes in excess of the petitioner's actual tax liability.

II.

We must say, as an initial reaction, that it strikes us as singularly eccentric that a matter as important to the natural gas industry as the Commission's about-face on liberalized depreciation should be resolved in an Alabama-Tennessee rate increase proceeding. Or that the only pertinent testimony came from one witness. And that this lone witness was the intervenor's, not the Commission's witness.[46] Nevertheless, taken separately or cumulatively, these eccentricities do not rise to the level of fatal procedural defects. The Commission has such an immense

[46] This witness, Melwood Van Scoyoc, testified in *Amere* on behalf of several cities opposing the requested ruling and made the same contentions the Commission relies upon here. 15 F.P.C. at 769.

task to perform that what might seem an eccentricity to the court may instead be a pragmatic administrative adjustment to the immensity of the Commission's task.

A. Alabama-Tennessee contends that the question of liberalized depreciation was not properly in issue. Neither the Commission's staff nor the petitioner expressly raised it and neither presented evidence with respect to it at the original hearing. However, the intervenor, Tennessee Valley Municipal Gas Association, whose members account for over 80 per cent of Alabama-Tennessee's natural gas sales subject to FPC jurisdiction, raised the point and produced an expert to testify on the issue.[47] Neither the Commission nor Alabama-Tennessee objected to the intervention.

The liberalized depreciation issue may be considered as much a part of the rate hearings as any other element of expense. As petitioner itself observes, since 1954 that question has been raised continually in rate proceedings.[48] We conclude that the issue was properly raised in this case, and that petitioner received enough notice of its significance to have protected itself by rebuttal evidence before the end of the hearing.

At the time of the hearing it was reasonable for the petitioner to rely on the Commission's then well-estab-

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[47] The Commission's rules on intervention are liberal. Once the petition to intervene has been filed, the Commission and other parties may file an answer and in default thereof, may be deemed to have waived any objection to the granting of the petition. FPC Rules of Practice and Procedure §§ 1.8(c), 1.8(d), 18 C.F.R. §§ 1.8(c), 1.8(d).

[48] Even though the Commission had clearly stated its policy in Amere Gas Utilities Company, 15 F.P.C. 760 (1956), the liberalized depreciation issue was repeatedly raised and disposed of in later cases, including El Paso Natural Gas Co., 22 F.P.C. 260, (1959); United Fuel Gas Co., 23 F.P.C. 127, (1960); Phillips Petroleum Co., 24 F.P.C. 537, (1960).

lished policy of allowing normalization. It was not unreasonable for the petitioner to assume that the Commission's failure to offer witnseses on flow-through normalization indicated that the Commission had no intention to reverse itself. But when the Commission issued its order severing depreciation from other issues that action should have put the petitioner on guard and provoked prompt defensive measures. Instead, the petitioner made no effort to introduce rebuttal evidence by reopening the record as provided in the Commission's Rules of Procedure[49] and in the Administrative Precedure Act.[50] Alabama-Tennessee filed only an application for "rehearing" (reconsideration) of the Commission's order for oral argument on the liberalized depreciation issue. This motion protested the reopening of the cases on the ground, among others, that petitioner had given no evidence in the hearing on the liberalized depreciation issue. Following denial of this motion, Alabama-Tennessee still failed to file a petition for introduction of additional evidence. Even after the Commission adopted the flow-through principle, petitioner did not seek leave of court to adduce additional material evidence under Section 19(b) of the Natural Gas Act.[51]

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[49] Sections 1.33(a) and (c) of the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 1.33(a) and (c)) provide that a "petition to reopen the proceeding for the purpose of taking additional evidence" may be filed when an Examiner's "initial decision has been issued . . . but no Commission decision has yet been issued."

[50] See Section 7(c), 5 U.S.C. § 1006(c).

[51] 15 U.S.C. § 717r(b): "• • • If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. • • •" See Sun Oil Company v. Federal Power Commission, 5 Cir. 1958, 255 F. 2d 557.

We conclude that the initial prejudice from lack of notice evaporated; that the petitioner was not deprived of statutory rights or constitutional due process.

B. The petitioner charges the Commission with an abuse of discretion in severing the liberalized depreciation issue and in deciding it in a rate making proceeding under Section 4 of the Natural Gas Act rather than a rate investigation under Section 5(a) of the Act. The difference is significant, petitioner argues, because the burden of proof shifts to the Commission in a rate investigation. In addition, the petitioner asserts, the effect of the approach the FPC used was to deprive other interested parties in the natural gas industry who would have made extensive evidentiary presentations in the original proceedings. The petitioner takes the position that Opinion No. 360 disposing of all the other issues in the case in effect terminated the rate making proceeding, and later oral argument on the liberalized depreciation issue was the equivalent of a new rate investigation by the Commission.

According to the Commission, severance of the flow-through/normalization issue expedited disposition of Alabama-Tennessee rate increase cases. This explanation is somewhat less than obvious: the hearing commenced July 13, 1960; the examiner gave his decision September 25, 1961; the Commission issued its severance order July 1, 1962; Opinion No. 360 came down June 13, 1962; the oral argument was held May 16, 1963; the Commission did not issue Opinion 417 until February 3, 1964 and its final order (Opinion 417a) until April 15, 1964. Since the Commission's recantation affects only the fourth case, it can be said that the three earlier cases were expedited.

We have already decided that liberalized depreciation was properly in issue in the ratemaking proceedings. Accordingly, we find that the Commission's action in reserving decision and ordering additional argument on the liberalized depreciation issue was not an abuse of its dis-

cretion. See *Federal Power Commission* v. *Tennessee Gas Transmission Company*, 1962, 371 U.S. 145, 154-55, 83 S. Ct. 211, 9 L. Ed. 2d 199, 206, holding that the issuance of an interim order making a partial reduction in a proposed increased rate on the basis of decision of one issue, and deferring decision on the remaining questions was "an appropriate exercise of the power granted the Commission by the Act."

The Commission was not obligated to decide the rapid depreciation issue in a rule making rather than a rate-making proceeding. The choice between proceeding by general rule or by individual, ad hoc litigation is one that lies in the informed discretion of the administrative agency.[52] *Securities and Exchange Commission* v. *Chenery*, 1947, 332 U.S. 194, 202-03, 67 S. Ct. 1575, 91 L. Ed. 1995, 2002. The borderline between rulemaking and adjudications is not precise. Rules are typically designed to apply to unnamed parties, but may sometimes be directed to a problem of a named individual or a small group; adjudications are typically designed to apply to named

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[52] "It should therefore be emphasized, as the FTC recognized in the trade regulation rule proceeding, that the choice between rulemaking and adjudication is not necessarily the choice between the articulation of a rule and an *ad hoc* approach in which each case is governed only by a general statutory provision. Agencies, like courts, frequently evolve detailed and precise rules in the course of adjudication. Indeed, it is worth noting that in Judge Friendly's lectures on the need for better definition of standards, his examples of successful formulation are taken from instances of adjudication. . . . The soundness and lawfulness of any given rule may be subject to challenge, but the existence of general authority to act in this manner can hardly be questioned, and it is evident that the effect of such a rule is to narrow and simplify the issues requiring resolution in subsequent cases." Shapiro, The Choice of Rulemaking or Adjudication in the Development of Administrative Policy, 78 Harv. L. Rev. 921, 926 (1965). See also Fuchs, Agency Development of Policy Through Rule-Making, 59 Nw. U.L. Rev. 781, 800 (1965).

parties, but may involve hundreds or thousands of parties. Opinions that accompany adjudications may have essentially the same effect as rules. 1 Davis, Administrative Law § 5.01 (1958). In this case the Commission felt that the time had come to reexamine the ratemaking treatment of liberalized depreciation. In applying its new policy to Alabama-Tennessee, the Commission could not overlook the wide application the change in policy would have on the natural gas industry. It was for the Commission to decide how to allow interested parties to present their views.[53] It was clearly within the ambit of reasonable discretion to allow participation by amici in oral argument and by the filing of briefs.

We do not say that the Commission chose the best procedure for changing a longstanding policy. As long, however, as the Commission stays within constitutional and statutory limits, it is competent to determine whether to deal with a policy problem in an adjudicatory proceeding,

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[53] "The device of the brief amicus curiae, which has become increasingly common in Supreme Court proceedings, has also been used by administrative agencies. . . . True, the use of such a device rests within the discretion if not the whim of the agency, but there is no reason why it cannot fulfill any perceived need for general reaction to a proposed policy. Especially since section 4 of the APA permits participation in rulemaking to be limited to written submissions and since an amicus may be allowed to make an oral presentation, the difference between the two approaches in terms of opportunity for comment does not seem substantial." Shapiro, *supra* note 52, at 931. Professor Shapiro noted that some questions may turn on the fact that an amicus is not a "party" to the administrative proceeding, citing Opinion No. 417-A in *Alabama-Tennessee. Ibid.* & n.37. However, the only question in No. 417-A that turned on this distinction was whether the amici had a formal right to petition for rehearing of the original No. 417. The Commission held that the amici did not have this right, but it went on nonetheless to consider the amici's contentions made in their applications for rehearing "because of the importance and industry-wide implications" of the new § 167 policy determination. 31 F.P.C. 928, 929 (1964).

a rulemaking proceeding, or a special proceeding of the type employed in this case. *Securities and Exchange Commisison* v. *Chenery Corp., supra,* 332 U.S. at 203, 67 S. Ct. at 1580, 91 L. Ed. at 2003. The order under review here leaves any pipeline company not a party to this proceeding free to introduce evidence demonstrating the inapplicability of the Alabama-Tennessee ruling to its individual situation. See, e.g., *Natural Gas Pipeline Co. of America,* FPC Op. No. 456-A, Fed. Util. Law Rep. ¶ 10,626 (June 23, 1965). We conclude that the Commission was within its power in adopting flow-through for Alabama-Tennessee in a proceeding under Section 4 of the Natural Gas Act, even though the findings and order with respect to petitioner establish a policy that may also affect other interstate pipeline companies.

Petition DENIED.

UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

October Term, 1964

No. 21610

ALABAMA-TENNESSEE NATURAL GAS COMPANY, *Petitioner,*

versus

FEDERAL POWER COMMISSION, *Respondent.*

ON PETITION TO REVIEW ORDERS OF THE FEDERAL POWER COMMISSION.

Before WISDOM and GEWIN, Circuit Judges, and BREWSTER, District Judge.

Judgment

This cause came to be heard on the petition of Alabama-Tennessee Natural Gas Company, for review of Orders of the Federal Power Commission issued on February 3, 1964 and April 5, 1964, in Docket Nos. G-5471, et al., and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered, adjudged and decreed by this Court that the Petition for Review in this cause be, and the same is hereby, denied.

March 25, 1966

Issued as Mandate:

The Natural Gas Act

Sec. 4. (d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulations, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company[1a] or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect;[1a] and after full hearings, either completed before or after the rate, charge, classification, or service

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[1a] Subsection 4 (e) was amended May 21, 1962 by Public Law 87-454, 87th Congress, 2d Session [S. 1595], 76 Stat. 72.

goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible. [52 Stat. 822 (1938); 76 Stat. 72 (1962); 15 U.S.C. § 717c]

Sec. 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract

to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

Internal Revenue Code 1954

§ 167. *Depreciation*

(a) General rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

(b) Use of certain methods and rates.—For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary or his delegate, under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method productive of an annual allowance which, when added to all allowances for the

period commencing with the taxpayer's use of the property and including the taxable year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 286

ALABAMA-TENNESSEE NATURAL GAS COMPANY,
Petitioner

v.

FEDERAL POWER COMMISSION, *Respondent*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

Brief for Independent Natural Gas Association of America, Amicus Curiae, In Support of Petition

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Brief for Independent Natural Gas Association of America, Amicus Curiae, In Support of Petition

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This brief, *amicus curiae,* is filed with the consent of the parties.

INTEREST OF AMICUS CURIAE

Independent Natural Gas Association of America (INGAA) is a non-profit national trade association whose membership includes most of the interstate natural gas pipeline companies subject to the jurisdiction of the Federal Power Commission (Commission). For many years INGAA has appeared in rule-making, rate and certificate proceedings before the Commission

involving issues affecting the natural gas industry generally. It has participated in proceedings before this Court and the various federal appellate courts in cases arising out of Commission orders. Similarly, in the instant case, INGAA has participated as *amicus curiae* both in the proceedings before the Commission and in the court below.

In reliance upon the Commission's earlier court-approved decisions prescribing normalization, many of INGAA's pipeline company members have utilized the liberalized depreciation methods authorized by Section 167 of the Internal Revenue Code of 1954 to defer, temporarily, the payment of a portion of their federal income tax liability, and have invested the deferred tax funds in plant expansion as admittedly intended by Congress. Now, however, the court below has approved an "about-face" by the Commission which requires the regulated pipeline company to "flow through" currently to its customers all of the tax benefits of Section 167. Thus, the effect of the court's decision is to transform Section 167 from a provision intended to make funds available to all businesses to invest for the public benefit into a rate-reducing provision for the exclusive benefit of the present customers of the regulated company. In addition, the court below has also affirmed the Commission's order denying to natural gas pipeline companies any return upon the already constructed plant additions relating to the deferred taxes which were previously accumulated in reliance upon the prior policy.

The Court's decision clearly will affect the natural-gas pipeline industry generally.

In addition to expressly making its findings applicable to "Alabama-Tennessee and other natural

gas companies similarly situated" (R. 153), the Commission held in its Opinion that:

> ". . . The decision rendered herein will constitute the final element in determining a just and reasonable level of return for Alabama-Tennessee and a proposed decision on this point with regard to the various other pipelines with respect to which this specific issue has been reserved." (R. 127)

With respect to the far-reaching scope of its decision, the Commission itself recognized:

> ". . . it is evident that the decision to be rendered in this proceeding will have a substantial impact upon other regulated companies subject to this Commission's jurisdiction." (R. 127)

Manifestly, therefore, this is an important question and INGAA's member companies have a vital interest which will be affected by this Court's action in the instant proceeding.

REASONS FOR GRANTING THE WRIT

Alabama-Tennessee's petition fully demonstrates the need for review by this Court of the decision below. INGAA will, therefore, merely supplement this showing by highlighting the following considerations.

1. The Decision Below Conflicts With a Decision of Another Court of Appeals

The decision of the Court of Appeals below is directly in conflict with an earlier decision of the Court of Appeals for the District of Columbia in *Panhandle Eastern Pipe Line Co.* v. *FPC*, 316 F. 2d 659 (1963), *cert. denied*, 375 U.S. 881. That case involved an appeal by Panhandle which contended that the return of

1½ percent allowed by the Commission on the reserve for deferred taxes accumulated under the Commission's policy of normalization was insufficient to satisfy the Congressional intent in enacting Section 167. The D. C. Circuit, with all nine judges sitting *en banc,* reviewed the matter and by a five-four majority affirmed the Commission's action. The court in *Panhandle* was unanimous in agreeing that Congress did intend to "provide incentives to initial investment" through liberalized depreciation (*id.* at 662), with the four dissenting judges being of the view that even normalization *plus* 1½ percent return, fell short of satisfying the mandate of Congress.

Contrary to the Fifth Circuit's rationalization, the validity of normalization itself was necessarily implicit in the *Panhandle* decision. The disagreement between the majority and the minority in that case centered on the extent of the incentive required. The question, as stated by the court majority in *Panhandle,* was:

> ". . . whether the congressional purposes underlying the tax and gas acts are effectuated by permitting a rate of return on the funds generated by the use of liberalized depreciation no higher than that required to provide the company with 'a sufficient incentive to continue to use liberalized depreciation.' " (*Id.* at 661-662)

The majority then went on to state:

> "Since there is no indication that Congress intended to bestow upon producers *qua* producers any benefits beyond those necessary to provide incentives to investment, we conclude that, if a return of 1.5 per cent taken with the other advantages does provide such incentive, the Commission's decision would be consistent with the

Congressional policy underlying the tax statute." (*Id.* at 663)[1]

In a vigorous dissent, Judge Miller, joined by three other judges, contended that the majority erred in not requiring the Commission to give Panhandle the same full return on the deferred tax accruals included in the rate base as it applied to the rest of the rate base. Nowhere in the District of Columbia Circuit Court's decision in the *Panhandle* case does the court, in the words of the Fifth Circuit, "put the Commission and the natural gas industry on notice that, for ratemaking purposes, Section 167 was not a congressional mandate to regulatory agencies to approve normalization." (359 F. 2d at 329) Such a ruling by the Fifth Circuit is totally inconsistent with the *Panhandle* deci-

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[1] The majority quoted with approval the Commission's enumeration of the "other advantages":

> "The other 'material advantages' which the Commission found would result from 'the use of deferred taxes to supply a portion of the company's capital requirements,' are as follows:
>
> > 'The substantial sums involved are readily available without resort to the market, and such additions to capital serve to reduce the company's debt ratio. The acquisition of plant by use of deferred taxes provides additional security not subject to lien on which new loans can be based, perhaps at lower interest rates than would otherwise be possible. Furthermore, deferred tax funds accumulated between rate cases and invested in plant may, during that period, increase the company's earnings. Finally, the accumulation of deferred taxes increases the company's funds available for expansion without issuing additional common stock.'" (id. 662, fn. 5).

Of course, none of these advantages would be available to Petitioner under the ruling of the court below. The timing of the Commission's reversal of policy would seem to be particularly inopportune. Under the new policy, deferred tax funds will no longer be available to pipelines for expansion at the present time when interest on borrowed funds is approaching an all-time high.

sion, and the court below made no effort to resolve the conflict.

The Fifth Circuit's misguided reasoning is well demonstrated by reference to the ultimate conclusion reached, where it said:

> "In final analysis, *putting to one side the issue of congressional intent,* the petitioner's challenge to the FPC order addresses itself to the competency of the Commission to choose between competing accounting theories and competing economic guesses. We see nothing irrational in the Commission's choice." (359 F. 2d at 339) (emphasis supplied)

It is difficult to imagine how the issue of Congressional intent can be put to one side and a correct decision reached. Petitioner's whole case devolved upon the question of Congressional intent in making the tax benefits of liberalized depreciation available to Petitioner and other pipelines. By side-stepping this critical point, there is, in truth, no decision at all on the real issue raised by Petitioner's appeal. In *Panhandle,* the Court of Appeals for the District of Columbia explicitly held that the Commission's order there was "consistent with the Congressional policy underlying the tax statute" (*Id.* at 663). By no stretch of the imagination can *Panhandle* stand side by side with the Fifth Circuit's decision, as it reaches a diametrically opposite result.

The conflicting decisions reached by the two appellate courts illustrate the problem with which the regulated companies have been faced over the last twelve years since the enactment of Section 167 of the Internal Revenue Code of 1954. It is time, *amicus* submits, that the issue herein and the conflicting decisions thereon be resolved by this Court.

2. The Decision of the Court Below Raises an Important Question Which Should Be Resolved by This Court

In ruling that the Commission's treatment of liberalized depreciation was within the Commission's regulatory competence and hence should be permitted to stand, the court below, in sharp contrast to the District of Columbia Court of Appeals in the *Panhandle* case, ignored the clear intent of Congress and has permitted an improper substitution of Commission judgment for that of Congress in a matter of vast national importance.

Congress, in 1954, enacted Section 167 as an investment incentive for the business community generally, making no distinction between regulated and non-regulated industries. The stated Congressional purpose in making these liberalized depreciation methods available was to stimulate all segments of the economy by accelerating the placement of funds in the hands of all businesses as an inducement to new investment. As stated by the House Ways and Means Committee (H. Rep. No. 1337, 83d Cong., 2d Sess., p. 24):

> ". . . For *all* segments of the American economy, liberalized depreciation policies should assist modernization and expansion of industrial capacity, with resulting economic growth, increased production, and a higher standard of of living."[2] (emphasis supplied)

The choice of the means to the end of aiding the national economy was entirely deliberate; it was only after a spirited debate that monetary relief was granted by Congress to businesses generally in Section 167 rather than to individuals in the form of income

[2] To the same effect, see also the Report of the Senate Finance Committee (S. Rep. No. 1662, 83d Cong., 2d Sess., p. 25).

tax reductions.[3] Liberalized depreciation, moreover, was viewed by its supporters as a tax deferral, a shift in deductions between taxable years, rather than an outright loss in revenue. Perhaps even more significant, the measure was expected to have such a substantial incentive effect that, even in the early years, there would be no loss in revenues.[4]

The optional aspect of liberalized depreciation deserves particular emphasis. For if a company does not elect to take liberalized depreciation, there can be no benefits to anyone, whether denominated a "tax saving", as the Commission found, or a tax deferral, as stated by Congress.

Uncertain whether to elect to take accelerated depreciation on their new assets, many gas pipeline companies sought an early determination from the Commission of the regulatory treatment to be accorded this incentive measure. On June 30, 1956, after a full hearing, the Commission made such a ruling[5] in which it specifically held that the Congressional purpose in enacting Section 167 required that the gas pipelines depreciating assets under this section be permitted to retain and realize the benefits of liberalized depreciation.[6]

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[3] H. Rep. No. 1337, *supra*, at App. B4, where the Committee minority states that the most effective incentive to business would be to increase consumer purchasing power by tax reductions to individuals. This viewpoint found expression in proposed amendments in both the Senate and the House to increase the personal income tax exemption. For a comprehensive analysis dealing with this and other aspects of this legislation, see *Liberalized Depreciation; About-Face by the FPC*, 30 Va. L. Rev. 298-366, March 1964.

[4] H. Rep. No. 1337, *supra*, at p. 25.

[5] *Amere Gas Utilities Co., et al.*, 15 FPC 760, 781 (1956).

[6] *Id.* at 782.

Following *Amere*, the Commission, from that time until the instant case, uniformly permitted normalization.[7] Pipeline companies, relying on these formal Commission pronouncements, elected to take advantage of the tax incentives urged upon them by Congress. Moreover, the Commission's treatment of tax deferrals for rate case purposes received judicial approval in every instance where the Commission's action was reviewed, including the Fifth Circuit in *El Paso Natural Gas Co.* v. *FPC*, 281 F. 2d 567 (1960), *cert. den.* 366 U.S. 912; see also *Cities of Lexington, et al.* v. *FPC*, 295 F. 2d 109 (4th Cir. 1961), and *Panhandle Eastern Pipe Line Co.* v. *FPC*, 316 F. 2d 659 (D.C. Cir. 1963), *cert. den.*, 375 U.S. 881. The Commission decision under review is, therefore, a complete "about-face."

Nor is this complete reversal applicable *in futuro* only. The Commission's order directs that accumulated deferred taxes relating to *past* plant additions be deducted from the rate base, thus denying any return upon the tax deferrals already accrued. The pipelines, acting in good faith reliance upon the Commission's judicially-sanctioned formal pronouncements, initially elected, and continued to utilize, liberalized depreciation and irrevocably committed the funds so generated for the construction of new facilities and the expansion of their plants. For so doing, they are now being

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[7] *E. g., El Paso Natural Gas Company*, 22 FPC 260; *United Fuel Gas Co.*, 23 FPC 127; *Phillips Petroleum Co.*, 24 FPC 537; *Northern Natural Gas Co.*, 25 FPC 431; *Kansas Nebraska Natural Gas Co.*, 25 FPC 448; *Panhandle Eastern Pipe Line Co.*, 25 FPC 550. This was consistent with the Commission's judicially-sanctioned treatment of Section 168 of the Internal Revenue Code which permitted rapid depreciation of emergency facilities constructed in the interest of national defense. *City of Detroit* v. *FPC*, 230 F. 2d 810, 822 (D.C. Cir. 1955), *cert. den.*, 352 U.S. 829.

penalized, not only prospectively, but retroactively. Indeed, had the companies known what the Commission's action here would be when the question was first raised in *Amere* almost twelve years ago, they would not have elected to use liberalized depreciation. Absent the advantages of the deferred tax funds which normalization would generate, straight-line depreciation is the only stable, suitable, consistent method for the regulated companies to use in computing tax depreciation deductions.

The error in the affirmance by the court below of the Commission's 180-degree turn in this case lay principally in its refusal to recognize the specific Congressional intent embodied in the tax statute and in its inability to reconcile the rate provisions of the Natural Gas Act with what it thought were conflicting provisions of Section 167 of the Internal Revenue Code of 1954. In essence, the court found that the aims and objectives of Section 167, in providing tax benefits to the taxpayer (*i.e.*, the pipeline) were incompatible with the aims and objectives of Sections 4 and 5 of the Natural Gas Act which require that only just and reasonable rates be charged, citing *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944). The short answer is that there is no incompatibility whatever between the two statutes as is evident from the long list of decisions (cited above, p. 9) in which Federal appellate courts have considered this question. While it is true that the *Hope* case, as the court below points out, is often cited for the proposition that the primary purpose of the Natural Gas Act of 1938 was to protect the consumers, it is also true that the Supreme Court, in that case, recognized that "The rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the con-

sumer interests" (*Id.* at 603). No one denies, on the other hand, that Section 167 was enacted for the primary benefit of the taxpayer. Thus, it can be seen that the two statutes are designed to serve separate and distinct purposes. The Court of Appeals for the District of Columbia in the *Panhandle* case, *supra,* had no difficulty in reconciling the separate statutory purposes in approving normalization coupled with a return of 1½ percent on the funds generated thereby:

> "Here the Commission, following its decision in Northern Natural Gas Co., 25 F.P.C. 431 (1961), 'divided the benefits of liberalized depreciation between the regulated company and the rate-payer' giving the 'major portion of the benefits to the rate-payer.' It permitted Panhandle 'only so much of [a return on funds generated by the use of liberalized depreciation] as is necessary to provide it with a sufficient incentive to continue to use liberalized depreciation.' Thus, a substantially lower rate of return was attributed to those funds than to other capital." 316 F. 2d at 661.

Crucial to the Commission's new position is its finding that the intent of Congress to stimulate the economy will be fulfilled by flowing through the benefits of liberalized depreciation to the consumers in the form of lower rates thereby increasing consumer buying power which, in turn, will increase the demand for natural gas with a consequent need for more facilities. But had Congress intended that kind of stimulus, it would have so provided. Congress did not simply express a desire to stimulate the economy by enactment of Section 167. It also chose a specific method to do so—by provision of tax deferred funds to business for investment. The legislative history of Section 167, discussed *supra* (pp. 7-8), shows that efforts to stimulate the economy by tax reductions were ex-

pressly rejected by the Congress in favor of the tax incentives for industry provided by Section 167. The Commission's reasoning here is identical with that of the minority views in Congress which opposed Section 167. The Commission is thus adopting the method that Congress itself rejected.

In addition, the record in the instant proceeding is barren of any factual evidence to support such a finding. Had an opportunity been provided as sought by both Petitioner and the pipelines, it would have been shown that a reduction in rates, of the magnitude here involved, would not provide the stimulus contemplated by the Commission.

Accepting the Commission's reasoning, the Court of Appeals concluded that a regulated utility will *never* be required to pay higher income taxes, because of its election to claim liberalized depreciation, *unless* its gross plant declines in dollar value as a result of lower demand or lower plant construction cost (359 F. 2d at 336). Both the court and the Commission conceded that this conclusion rested on speculation as to what the future risks of the gas companies would be both in terms of growth potential and in having the cash requirements in the future to pay the deferred taxes. Though the record on this important question is devoid of meaningful, substantial evidence, as to the accuracy of its premises, the court, with the same illogic pervading the Commission's order, concluded that the case for normalization requires more speculation than the case for flow-through. Quite aside from the fact that many of the Commission's contentions were presented to Congress and rejected, normalization requires far less speculation than flow-through. This is so because normalization provides no higher rates to consumers than would be charged if the pipe-

lines did not utilize liberalized depreciation for tax purposes. The risks of economic obsolescence and competition present a far greater danger under flow-through than under normalization. Flow-through places an intolerable burden on the pipeline companies to assume the risk of not having sufficient revenues in the future to pay the higher taxes resulting from present use of liberalized depreciation. Moreover, flow-through, in contrast to normalization, distorts the true earnings picture of individual pipeline companies, making this important test of investor interest and reliance meaningless, if not completely misleading. Such a result runs counter to the clear responsibility which the Commission has to the investing public with respect to the earnings reported by industries subject to its regulation.

3. The Commission Procedure Denied a Fair Hearing

It is indeed "singularly eccentric", as concluded by the court below, "that a matter as important to the natural gas industry as the Commission's about-face on liberalized depreciation should be resolved" (359 F. 2d at 341) in long pending rate cases of one of the smallest interstate gas pipeline companies. The court below erred, however, in holding that such admitted eccentricities do not render the procedure below fatally defective.

Even assuming, *arguendo*, that the Commission properly extended the scope of Alabama-Tennessee's rate case to include the liberalized depreciation issue, the procedure adopted by the Commission effectively denied to INGAA and other interested parties, as well as Alabama-Tennessee, their statutory right to participate fully in the hearing; to submit evidence; to produce and cross-examine witnesses; and to spread upon

the record all pertinent facts bearing upon this issue of industry-wide importance. *Morgan* v. *United States,* 304 U.S. 1, 18-19 (1938); *Ohio Bell Telephone Company* v. *PUC,* 301 U.S. 292, 304 (1937). Instead of affording such procedural and substantive safeguards before adopting the "about-face" order which eventuated, the Commission at the very last stage of the rate proceeding, and 20 months after the hearing record was closed, invited participation, as *amici,* "either in the oral argument, or by the filing of written briefs", by any person, company, association or governmental authority "having an interest in the problem" (R. 64-66).

Nor did the Commission permit those "having an interest in the problem" to develop an evidentiary record even though it conceded, in its Opinion, that the tax consequences of liberalized depreciation must be evaluated in the light of such factual considerations as demand for gas, plant capacity, adequacy of gas reserves, level of plant construction costs and the likelihood and impact of declining plant additions (R. 142). To resolve these factual matters, the Commission relied on statistical data outside the record on the ground that they were subject to administrative notice. However, not only do these critical underlying issues involve highly controversial factual matters, but cross-examination would have shown the material on which the Commission relied to be either unreliable or inapplicable. The Commission's action thus improperly utilized the doctrine of administrative notice as "a pretext for dispensing with a trial" at which the interested parties would have been afforded an opportunity

to offer evidence and cross-examine on these critical factual issues. Cf. *Ohio Bell Telephone Co.* v. *PUC*, *supra*, at 302.

Objections to the procedure followed by the Commission were shrugged off with the comment that other pipelines would be afforded an opportunity (after the fact) to show cause why the determination made here is not applicable to them (R. 127). With *scant* opportunity in the first and precedent-setting case to show why the Commission should not reverse its earlier judicially-approved decisions requiring normalization and *no* opportunity to establish evidentiary support for their position, the burden was imposed upon the pipelines to show cause, in the form of exceptional circumstances why they should continue to receive the tax incentives which Congress specifically made available to them. It is a hollow gesture to assert, as does the Commission and the court below, 359 F. 2d 343, that each pipeline company will be given the opportunity to show why it should be permitted to follow normalization when employing liberalized depreciation. As this Court stated in somewhat comparable circumstances, to place that burden on these companies "is in effect to make its hearing a rehearing . . . rather than a hearing on the merits of its own application." Such a hearing does not satisfy either the "spirit or intent" of the law. *Ashbacker Radio Corp.* v. *FCC*, 326 U.S. 327, 331 (1945).

CONCLUSION

For these reasons, as well as those stated by Petitioner, Alabama-Tennessee, the petition for a writ of

certiorari, filed herein by Alabama-Tennessee, should be granted.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 286

ALABAMA-TENNESSEE NATURAL GAS COMPANY,
PETITIONER

v.

FEDERAL POWER COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL POWER COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a–43a) is reported at 359 F. 2d 318. The opinions of the Federal Power Commission (R. 126–177; 202–214) are reported at 31 F.P.C. 208, 928.

JURISDICTION

The judgment of the court of appeals (Pet. App. 44a) was entered on March 25, 1966. The petition for a writ of certiorari was filed on June 23, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Whether, in fixing the rates of a natural gas company, the Federal Power Commission may require the company to reflect tax savings obtained by use of the liberalized depreciation provisions of the Internal Revenue Code.

2. Whether in the circumstances of this case the Commission was required to reopen the record for the receipt of additional evidence.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the Natural Gas Act and the Federal Power Commission's Rules of Practice and Procedure are set forth in the Appendix, *infra*, pp. 16–19.

STATEMENT

The Federal Power Commission's order under review holds that the use by petitioner Alabama-Tennessee Natural Gas Company of rapid or liberalized depreciation in computing its income taxes resulted in tax savings that the pipeline must "flow through" to its ratepayers. Stated otherwise, the company may include in the cost of service (by which the reasonableness of the company's rates is measured) only the taxes it actually pays. Prior to its decision here, the Commission, acting on the supposition that liberalized depreciation resulted merely in tax deferrals, rather than tax savings, had permitted pipelines to "normalize" their taxes by including as a cost of service an amount equal to what the company would have paid in federal income taxes had it not used liberalized depreciation. The Commission had required the

"deferred" taxes to be carried on the company's books as a reserve account available for all corporate purposes except the payment of dividends, and had permitted the company to earn a return on the funds accumulated in this account. As a corollary to its adoption of the flow-through method, the Commission ruled that Alabama-Tennessee's rates could no longer reflect any return on such accumulation.

The Commission proceeding arose out of four successive increased rates filed by petitioner between 1954 and 1959. The Commission had suspended each of these rates for the maximum five-month statutory period and set them down for a hearing as to their reasonableness. In attempting to justify these rates, petitioner claimed, among other things, that it was entitled (1) to "normalize" its income taxes for cost-of-service purposes and (2) to receive a full return on the amount of its "deferred tax" reserve. During the hearings evidence was presented by the Tennessee Valley Municipal Gas Association, one of the intervenors who opposed the rate increases, to show that the excesses of "normalized" taxes over actual taxes were actually tax savings rather than tax deferrals; that rates should be fixed that would pass such savings to the customers; and that no return on previously accumulated "deferred" taxes should be allowed (R. 2–37). This testimony was subjected to cross-examination (*e.g.*, R. 37–42), but no rebuttal evidence was offered.

The examiner, following Commission precedents, rejected the flow-through theory. The intervening municipalities appealed, urging the Commission to re-

consider its treatment of liberalized depreciation for rate purposes, and pointing out that the Commission itself, in its Brief in Opposition to the State of California's petition for a writ of certiorari in the *El Paso* case,[1] had stated that the adoption of flow-through or normalization was discretionary with the Commission (R. 61–63). The Commission severed the liberalized-depreciation issue and set it down for special argument (R. 64–66), stating that it desired to hear argument with respect to all possible methods of handling liberalized depreciation for rate purposes and inviting the participation of *amici curiae* (R. 65–66). Fourteen separate *amici* briefs were filed representing all points of view in the natural gas and electric power communities.

On February 3, 1964, the Commission, by a 3–2 decision, held that in the future petitioner should flow through the tax reductions produced by liberalized depreciation. The Commission explained that its earlier approach had been based on the erroneous view that Congress' purpose in authorizing liberalized depreciation—to facilitate the modernization and expansion of industrial capacity—could be achieved only through normalization. The Commission pointed out that, while the courts had upheld its previous position allowing normalization, they had uniformly rejected the contention that Congress had prescribed how liberalized depreciation should be treated in fixing rates. Rather, the decisions rested "on in-

[1] *El Paso Natural Gas Co.*, 22 F.P.C. 260, affirmed on the liberalized depreciation issue, 281 F. 2d 567 (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366 U.S. 912.

dulgence of the Commission's finding that in practical effect a tax deferral rather than a tax savings was involved" (R. 130–136). Here, however, neither the evidence in the record nor the submissions of the *amici* indicated any factual support for the deferral theory: On the other hand, the exhibits and testimony introduced by the municipal intervenors (R. 140) "established that the use of liberalized depreciation deductions produced a tax saving; that flow-through of these savings to consumers would not burden future taxpayers; and that such flow-through resulted in stable rates and did not impair the financial integrity of the company or adversely affect its ability to attract capital for plant expansion."

The Commission noted that "a regulated utility will never be required to pay higher income taxes because of its election to claim liberalized depreciation unless its gross plant declines in dollar value as a result of lower demand or lower plant construction costs" (R. 141–142). That was unlikely since "the pattern of growth in demand and plant capacity with respect to Alabama-Tennessee and in the gas pipeline industry generally will continue for the reasonably foreseeable future" (R. 145–146). Hence Alabama-Tennessee's use of liberalized depreciation would probably produce "a permanent tax reduction" rather than a "certain increase in future taxes" (R. 142).

The Commission also pointed out that stimulation of new investment in the gas pipeline industry depends primarily on lower rates (R. 147):

> * * * [N]o amount of additional funds will stimulate new pipeline investment unless the

> market for additional gas exists. In fact, if the pipeline's customers do not require additional facilities the facilities will not be built, even if the pipeline might otherwise be induced to make the investment, since this Commission is duty-bound to deny a certificate for any expansion which is not required by the public convenience and necessity.
>
> Lower rates tend to generate a higher volume of sales and thus ultimately to require expansion of gas transmission facilities. * * *

Finally, the Commission concluded that, in light of its finding that the reserve accounts it had permitted under the normalization theory were not, in fact, needed for the purpose for which they were allowed—to defray a future tax liability—they should now be regarded as consumer-contributed capital on which (R. 151):

> * * * the rate of return should be zero since rates must be fixed upon the basis of a company's actual total costs, including its cost of capital, and no cost has been incurred in the accumulation of these balances.[2]

The Commission expressly declined to make its decision in the present case binding upon any other company, although it did state that, as to four pending pipeline rate cases in which the liberalized-depreciation question had been left open, the present decision would constitute a tentative decision on the point (R. 127; see Federal Power Commission Rules of Practice and Procedure, § 1.30(b), 18 C.F.R. 1.30(b)).

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[2] The sums covered into the reserve accounts had of course been collected from the ratepayers.

The only contested case in which the present decision has been followed without a complete new hearing, *Natural Gas Pipe Line Co.*, 33 F.P.C. 574, petitions for review pending, C.A. D.C., Nos. 19604, 19836, was one where evidence with respect to normalization v. flow-through had been placed in the record prior to the present decision.

Alabama-Tennessee made timely application for rehearing (R. 177–201). It argued that it had not thought it necessary to introduce evidence in rebuttal to that offered by the municipal intervenors on the flow-through v. normalization issue because it "appeared to Alabama-Tennessee that the issue had been laid to rest particularly with the judicial affirmance of *El Paso* [*supra*, p. 4]" (R. 185). However, it made no proffer of evidence, and no request to reopen the record for the receipt of additional evidence; it did not request an opportunity to make a showing in opposition to any facts of which the Commission had taken official notice (as provided by Section 1.26(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. 1.26(d)); and it did not deny their correctness. Rehearing was denied (R. 210).

The court of appeals, in an exhaustive opinion by Judge Wisdom, unanimously affirmed the Commission's decision in all respects.

ARGUMENT

1. The question of the appropriate treatment for rate-regulation purposes of tax reductions resulting from the use of the liberalized depreciation method is, concededly, a recurring one of general interest and im-

portance in the regulatory community; and the present case represents a change in the thinking of the Federal Power Commission on the subject. Nevertheless, we do not think that the case calls for further review by this Court. The issue of flow-through v. normalization is basically one for resolution through the exercise of administrative discretion. When certiorari was sought in 1961 by the State of California, in the *El Paso* case, to review the Commission's earlier choice of normalization over flow-through, we stated:

> * * * Such a choice is not one which warrants review by this Court. Under the same principle, the choice is one which can be changed by the Commission should it become convinced the other method is preferable. * * * [*California* v. *Federal Power Commission*, 366 U.S. 912, O.T., 1960, No. 599, Brief in Opposition for Federal Power Commission, pp. 11–12].

Although the Commission has changed its approach, this precept remains unimpaired.[3]

(*a*) As the Court of Appeals for the Fourth Circuit

[3] The issue here is thus very different from that in No. 127, this Term, *Federal Power Commision* v. *United Gas Pipe Line Company of America, et al.*, in which certiorari has been granted to review another Fifth Circuit decision involving the treatment of tax reductions for rate purposes. There, the court of appeals held that the Commission, as a matter of law, is barred from allocating any part of the tax savings produced by the filing of consolidated returns to the regulated pipeline member of the consolidated group, if the group includes any company not subject to regulation which sustained tax losses and hence contributed to the group's over-all tax savings. The court reasoned that such an allocation would impermissibly involve the Commission in the regulation of activities outside of its jurisdiction. No such question of power is presented here.

pointed out in 1961 in *Cities of Lexington, etc., Ky.* v. *Federal Power Commission*, 295 F. 2d 109, where it sustained the Commission's previous view allowing normalization as within the range of the Commission's discretion, the rate treatment of liberalized depreciation is an area in which both federal and State regulatory agencies had adopted diverging views, with the "box score" then standing at 3–1 for the use of normalization at the federal level [4] and 22–18 at the State level (295 F. 2d at 112).[5] Nor is there novelty in a regulatory agency's changing from normalization to flow through; at least four State commissions have done so in the light of more mature consideration of the problem, with judicial approval in the one State

[4] The Interstate Commerce Commission follows flow-through. *Accounting for Federal Income Taxes*, 24 Fed. Reg. 1401, 318 I.C.C. 803, 808. The Securities and Exchange Commission and Civil Aeronautics Board still permit normalization, although the Civil Aeronautics Board refuses to allow any return on deferred tax balances. *General Passenger Fare Investigation*, 32 C.A.B. 291, 310, 326–327. (Actually, the Securities and Exchange Commission's practice is simply to require proper accounting and disclosure where normalization is otherwise permitted. Securities and Exchange Commission, Accounting Series, Release No. 85 (February 29, 1960).) The Bell Telephone system does not use liberalized depreciation for tax purposes. However, the Federal Communications Commission requires flow-through with regard to Western Union. *The Western Union Telegraph Co.*, 25 F.C.C. 535, 566–567; *Western Union Annual Report*, 1965, p. 20. Compare *American Telephone & Telegraph and Western Union Private Line Cases*, 34 F.C.C. 244, 356–357.

[5] After the court of appeals' decision in *Cities of Lexington*, Ohio switched from normalization to flow-through, *Re Cincinnati Gas & Electric Co.*, 35 P.U.R. 3d 392, 394–397, affirmed, 173 Ohio St. 473, 184 N.E. 2d 84, and Idaho adopted normalization, *Re Idaho Power Co.*, 46 P.U.R. 3d 166, 173–174.

where the commission was taken to court.[6] From this it appears—as we suggested in opposing the State of California's petition five years ago—that a regulatory commission's choice between the two methods is within the scope of its expert judgment.

(*b*) The Commission's discretion was in any event wisely exercised here. Under straight-line, or normal, depreciation, all depreciable property is written off in equal instalments over the course of its useful life. Section 167 of the Internal Revenue Code, however, permits a company (for tax purposes) to make larger deductions for depreciation in the earlier years. Under this method a company will have above-normal depreciation on its newer assets and below-normal depreciation on older assets. However, so long as the company continues to grow—so long as its plant additions and replacements exceed its plant retirements—it will have a larger depreciation deduction than under the straight-line method.

For the natural gas industry in general, and

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[6] Colorado: *Public Service Company of Colorado*, 12 P.U.R. 3d 158 (1956) (normalization); *Public Service Company of Colorado*, 34 P.U.R. 3d 186, 201–205 (1960) (flow-through); New Hampshire: *Order No. 6756*, 38 N.H. P.U.C. 18 (normalization) (1956); *Public Service Company of New Hampshire*, 18 P.U.R. 3d 523 (flow-through) (1957); Ohio: *Ohio Fuel Gas Co.*, 25 P.U.R. 3d 207, 209–210 (1958) (normalization); *Cincinnati Gas and Electric Co.*, 35 P.U.R. 3d 392 (1960) (flow-through), affirmed, *Cincinnati Gas and Electric Co.* v. *Public Utilities Commission*, 173 Ohio St. 473, 184 N.E. 2d 84; West Virginia: *Appalachian Electric Power Co.*, Case No. 4289, Forty-Second Annual Report of Public Service Commission of West Virginia, 332 (1955) (normalization); *Hope Natural Gas Co.*, 23 P.U.R. 3d 394, 400 (1958) (flow-through).

Alabama-Tennessee in particular, the Commission found that a pattern of growth would continue for the foreseeable future (R. 144–146), and accordingly that liberalized tax depreciation would consistently exceed straight-line depreciation, resulting in consistently lower taxes.[7] In these circumstances, to permit normalization is to require the ratepayers to provide funds against a contingency only remotely likely to occur.[8] To be sure, the Commission's conclusion that the use of liberalized depreciation results in tax savings, rather than deferrals, involves some projection into the future—but no more than would the conclusion that deferrals result. Indeed, as the court below pointed out (Pet. App. 33a), "the case for normalization requires more speculation than the case for flow-through. And it is at the expense of consumers."

(*c*) Petitioner's claim (Pet. 14–18) that the legislative history of Section 167 shows that Congress intended normalization to be the only allowable method for effectuating liberalized depreciation in the regulated sector has been uniformly and properly rejected. *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F. 2d 567, 572 (C.A. 5), certiorari denied *sub nom. California* v. *Federal Power Commission*, 366

[7] We point out that even if the pipeline's plant retirements equaled replacements, liberalized depreciation would result in no lesser deduction than under straight-line depreciation, and taxes, hence, would not be higher.

[8] Since the Commission in the present case permitted retention of the already large "deferred tax" reserves built up from previous normalization (R. 128, 143), large amounts remain available to meet the unlikely possibility that Alabama-Tennessee may one day have to pay above-normal taxes because of its use of liberalized depreciation.

U.S. 912; *Cities of Lexington, etc., Ky.* v. *Federal Power Commission*, 295 F. 2d 109, 114, 117 (C.A. 4); cf. *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 316 F. 2d 659, 662 (C.A.D.C.), certiorari denied, 375 U.S. 881. These decisions, while recognizing that Section 167 was intended to stimulate investment in plant, teach that the Commission is not rigidly confined in the manner of implementing this objective. Indeed, these very decisions invited the Commission to re-evaluate the issue, as it has now done.[9]

In claiming that normalization is *the* method prescribed by Congress to stimulate investment (Pet. 16–17), petitioner also overlooks the Commission's conclusion (R. 146–149) that providing a utility with additional free capital does not stimulate new investment in pipeline facilities unless there is a sufficient market for additional gas to warrant the issuance of a certificate of public convenience and necessity under Section 7(c) of the Act. There is no indication that there is any shortage of capital preventing the certification of additional facilities where there would be a market for the extra gas. Moreover, petitioner does not appear to challenge the Commission's con-

[9] Thus, there is no conflict, as petitioner claims (Pet. 11), with *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, *supra*. In addition, we point out that there was actually no issue in that case of flow-through v. normalization. The Commission order under review allowed normalization, and the only challenge was from the pipeline which claimed that more than 1½ percent return should be allowed on the capital provided by the reserves accumulated by normalization. The court made plain that it was not deciding any issues not decided by the Commission or challenged before it. 316 F. 2d at 661.

clusion that flow-through will stimulate investment because the resulting reduction of rates will "tend to generate a higher volume of sales and thus ultimately to require expansion of gas transmission facilities" (R. 147).[10]

2. Petitioner's allegations of procedural infirmities (Pet. 18–21) were, we submit, properly rejected by the court below (Pet. App. 33a, 35a–40a), and raise no issue warranting review by this Court.

(*a*) Petitioner contends that the Commission should have reopened the record after it severed the liberalized-depreciation issue. However, that issue had been timely raised by the intervening municipalities in the original hearing and petitioner could then have attempted to rebut the evidence introduced to support the claim that the Commission should change from normalization to flow-through. In its application to the Commission for rehearing, petitioner protested against severance of the liberalized-depreciation issue on the grounds (among others) that the record would not support the intervenors' position and that it had reasonably declined to present any evidence to rebut that introduced by the intervenors. However, as the court below noted (Pet. App. 39a–40a), even at this point petitioner made no request to reopen the record

[10] Petitioner, in arguing (Pet. 16) that flow-through is not a permissible method for implementing Congress' intent because Congress had refused to adopt a proposal for a tax reduction, neglects to mention that what had been rejected was not a *corporate* tax reduction, but a general tax reduction to lower bracket taxpayers as a direct aid to purchasing power. See 100 Cong. Rec. 3432, 3457, 3517–3522, 3527, 3530–3531, 3561–3563, 9063, 9168, 9267–9276, 9289, 9300, 9470, 9481; see, also, 100 Cong. Rec. 3299 (President's Address).

although it was free to do so. Sections 1.33(a)(1) and 1.33(c) of the Commission's Rules of Practice and Procedure, 18 C.F.R. 1.33(a)(1) and 1.33(c). Indeed, at no point has petitioner specified the kind of evidence that it would offer in the event of a reopening.

(*b*) Petitioner argues that the Commission improperly relied on secondary sources for factual determinations. However, the Commission is entitled, under both the Administrative Procedure Act, § 7, and the Commission's rules, § 1.26(d), 18 C.F.R. 1.26(d), to take official notice of facts within its specialized competence (see Attorney General's Manual on the Administrative Procedure Act (1947), pp. 79–80), provided that any party is, on request, given an opportunity to show the contrary. The Commission specifically identified the facts of which it was taking notice here (R. 144–146; see *Market Street R. Co.* v. *Railroad Commission of California,* 324 U.S. 548, 559–560), but, while objecting to reliance upon the facts noticed, petitioner did not ask that the record be reopened to permit it to controvert them.

(*c*) There is no merit to the contention that the present case was not a proper vehicle for deciding an issue of industry-wide importance. The ruling that Alabama-Tennessee must use flow-through is not binding upon other pipeline companies, who remain free, under the Commission's decision, to present evidence showing that factual differences between their cases and Alabama-Tennessee's justify their continuing to use the normalization method. See Statement, *supra,* pp. 6–7.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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Federal Power Commission.

JULY 1966.

APPENDIX

2. The pertinent portions of the Natural Gas Act, June 21, 1938, c. 556, 52 Stat. 821–833, as amended, 15 U.S.C. 717–717w, provide as follows:

Section 4(d), 15 U.S.C. 717c(d):

Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

Section 4(e), 15 U.S.C. 717c(e):

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and

delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

Section 5(a), 15 U.S.C. 717d(a):

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or

gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural-gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural-gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

3. Pertinent portions of F.P.C. Rules of Practice and Procedure are as follows:

Section 1.26(d), 18 C.F.R. 1.26(d):

Official notice of facts. Official notice may be taken of such matters as might be judicially noticed by the courts of the United States or of any other matter of technical or scientific fact of established character peculiarly within the general knowledge of the Commission as an expert body: *Provided,* That any party shall, on timely request, be afforded an opportunity to show the contrary.

* * * * *

Section 1.30(b), 18 C.F.R. 1.30(b):

Recommended or tentative decisions. In proceedings in which, prior to the filing of the presiding officer's report, the Commission, with notice to the parties, directs (in specific cases or by general rule) the certification to it of the rec-

ord for decision by the Commission, unless otherwise provided, the presiding officer's report shall constitute a recommended decision, except that in rule making or determining applications for initial licenses, in lieu thereof, (1) the Commission may designate any of its responsible officers to recommend a decision, or (2) the Commission may issue a tentative decision. Such recommended or tentative decision shall be served upon all parties, or their attorneys of record, and staff counsel, who may file exceptions in the manner and within the time provided in § 1.31.

Section 1.33(a)(1), 18 C.F.R. 1.33(a)(1):

By parties—(1) *Petition to reopen.* At any time after the conclusion of a hearing in a proceeding or adjournment thereof sine die, but before issuance by the presiding officer of an initial decision, any party to the proceeding or staff counsel may file with the presiding officer a petition to reopen the proceeding for the purpose of taking additional evidence. Copies of such petition shall be served upon all participants, or their attorneys of record, and shall set forth clearly the facts claimed to constitute grounds requiring reopening of the proceeding, including material changes of fact or of law alleged to have occurred since the conclusion of the hearing, and shall in all other respects conform to the applicable requirements of §§ 1.7 and 1.15 to 1.17, inclusive.

* * * * *

Section 1.33(c), 18 C.F.R. 1.33(c):

By Commission action. The above provisions of this section shall apply equally to petitions for and the issuance by the Commission of an order reopening the proceeding, where an initial decision has been issued by the presiding officer but no Commission decision has yet been issued, or where the initial decision by a presiding officer has been omitted and no Commission decision has yet been issued.

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IN THE

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OCTOBER TERM, 1966

No. 286

ALABAMA-TENNESSEE NATURAL GAS COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION, *Respondent.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

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1. The Commission (Br. in Opp. pp. 7-8) expressly concedes that the substantive question presented in the instant case is "a recurring one of general interest and importance in the regulatory community; and the present case represents a change in the thinking of the

Federal Power Commission on the subject." Despite these concessions, the Commission (Br. in Opp. p. 8) urges that the case does not warrant review by this Court and in this connection, the Commission (*Id.* fn. 3) undertakes to distinguish "[t]he issue here * * * from that in No. 127, this Term, *Federal Power Commission* v. *United Gas Pipe Line Company, et al.*, in which certiorari has been granted to review another Fifth Circuit decision involving the treatment of tax reductions for rate purposes."

The Commission's proffered distinction, however, is invalid. The Commission (Br. in Opp. p. 8, fn. 3) claims that *United Gas* involves a question of Commission power whereas "[n]o such question of power is presented here." This argument confuses the Commission's position herein with the question presented. To be sure, the Commission *argues* in this case that it has power and discretion to do what it did. But the question of the Commission's power is the very question on which review here is sought. The fact that the Commission argues that it has the power does not make it so.

The question presented by the Petition in this case, like that in *United Gas,* directly places in issue the power of the Commission, *viz.,* whether the Commission has power to require natural gas companies subject to its jurisdiction to pass through the particular Federal income tax benefits involved in the form of reduced rates. Significantly, the Commission's position in *United Gas* is the same as its position in the present case, namely, that the rate treatment to be accorded the particular Federal income tax benefit involved has been left by Congress to its administrative discretion.

It is, thus, apparent that the only difference between the two cases in this respect is that in *United Gas* the Court of Appeals rejected the Commission's position and held that the Commission lacked power to require the pass-through of those particular tax benefits whereas in the instant case, the court below agreed with the Commission in its ruling requiring flow-through of liberalized tax depreciation. Accordingly, since review by this Court obviously does not turn upon whether the Commission has won or lost in the courts below and since the question presented here, affecting as it does virtually the entire natural gas pipeline industry, is plainly of far greater importance and interest than that in *United Gas* (compare F.P.C. Petition in No. 127 at pp. 14-16),[1] the granting of certiorari in *United Gas a fortiori* requires that certiorari be also granted here.

2. In urging against certiorari here, the Commission (Br. in Opp. p. 8; see also Br. in Opp. of Tennessee Valley Municipal Gas Association [Association][2] at pp. 6, 8) places heavy reliance upon this Court's denial

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[1] The importance of the holding below has been accentuated by the Commission's Opinion No. 497 in *Midwestern Gas Transmission Company, et al.*, RP61-19, *et al.* (Reopened), issued on July 15, 1966, subsequent to the filing of the petition herein. In that case, the Commission extended its holding in the instant case to companies which had changed from liberalized depreciation to straight-line depreciation for Federal income tax purposes as a consequence of the Commission's "about face" herein. The Commission there held that it was an abuse of discretion for these companies to have changed to straight-line depreciation and required them to reduce their rates as if they were still using liberalized depreciation.

[2] We answer the arguments of the Association in this Reply Brief not because we believe that its Motion to be added as a respondent should be granted, but because we probably will not have a further opportunity to reply should the Court grant the Association's Motion.

of certiorari in *El Paso*[3] even though the Court of Appeals there had *affirmed* the Commission's normalization of liberalized depreciation in fixing the pipeline company's rates. In any event, it is well established, of course, that a denial of certiorari does not constitute a decision on the merits. Moreover, contrary to the Commission's arguments both here (Br. in Opp. pp. 11-12) and in its opposition in *El Paso* (No. 599, Oct. Term 1960 at pp. 7, 11-12) it is clear that the Fifth Circuit's approval in *El Paso* of normalization was in the context of an unbroken line of Commission rulings applying normalization in recognition of the Congressional mandate in enacting Section 167. Also, it is clear from the *El Paso* decision that the Court's approval of normalization was not based on a deference to administrative discretion.

In contrast, the Fifth Circuit's *acceptance* of flow-through in this case runs wholly counter to its *affirmance* of normalization in *El Paso*. Its action in this case was taken against the background of the Commission's repudiation of its prior consistent precedents on which many pipline companies had relied in electing to use liberalized depreciation coupled with a 180 degree about-face by the Commission as to the factual bases for its conclusion.

Moreover, like the Court of Appeals in *El Paso*, the District of Columbia Circuit's decision in *Panhandle Eastern Pipe Line Co.* v. *Federal Power Commission*, 316 F. 2d 659 (D.C. Cir. 1963), *cert. denied*, 375 U.S. 881 (1963) recognized normalization as being required

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[3] *El Paso Natural Gas Co.* v. *Federal Power Commission*, 281 F. 2d 567 (5th Cir. 1960), *cert. denied, sub. nom. People of the State of California, et al.* v. *Federal Power Commission*, No. 599, Oct. Term 1960, 366 U.S. 912 (1961).

by the Congressional purpose behind Section 167. Indeed, as shown in our Petition (at pp. 11-14), the *Panhandle* decision is in conflict with the Fifth Circuit's decision below.

Finally, the Commission's opposition to certiorari in *El Paso* was not limited to arguing administrative discretion. Instead, it made several other arguments which may well have constituted the basis for this Court's denial of certiorari in *El Paso*.[4] In view of this, it is significant that several of the Commission's arguments in *El Paso* directly contradict the Commission's critical contentions in the instant proceeding. For example, in seeking to demonstrate the wisdom of its "discretionary" action, the Commission *here* argues (Br. in Opp. pp. 10-11):

> "For the natural gas industry in general, and Alabama-Tennessee in particular, the Commission found that a pattern of growth would continue for the foreseeable future (R. 144-146), and accordingly that liberalized tax depreciation would consistently exceed straight-line depreciation, resulting in consistently lower taxes. In these circumstances, to permit normalization is to require the ratepayers to provide funds against a contingency only remotely likely to occur. To be sure, the Commission's conclusion that the use of liberalized depreciation results in tax savings, rather than deferrals, involves some projection into the future —but no more than would the conclusion that deferrals result. Indeed, as the court below pointed out (Pet. App. 33a), 'the case for normalization

[4] The Commission's opposition in *El Paso* improperly characterized the issue as "a relatively narrow * * * accounting problem" (p. 7) involving a "* * * choice among competing accounting systems" (p. 11). Its opposition here (at pp. 7-8) recognizes that the issue involves far more than just accounting.

> requires more speculation than the case for flow-through. And it is at the expense of consumers'."

In contrast, the Commission claimed in its *El Paso* opposition in support of *normalization* (at pp. 14-15) that:

> "* * * Petitioners' assumptions of a continual plant growth and a continuously expanding investment in depreciable property, *i.e.*, plant additions exceeding retirements, are at best largely speculative and conjectural. It was within the Commission's discretion to decline to make these assumptions. On the other hand, it is known, and petitioners must concede, that as the tax law now stands, higher deductions and lower taxes prevail only during the early depreciable life of a property unit, whereas lower deductions will prevail during its later life. Petitioners therefore do not, and cannot, show that the ultimate net result will be an outright tax saving."[5]

Thus, the Commission's present position in favor of flow-through, as to factual matters, is grounded primarily on conclusions directly contradictory to those espoused by the Commission when it was justifying normalization in *El Paso*.

3. In view of the nature of the Commission's findings in support of flow-through, and in view of the conceded widespread importance of its decision to the entire natural gas pipeline industry (Br. in Opp. p. 8), there is a particular need to assure that such a drastic reversal of prior findings be made only on a comprehensive record in which all interested parties have had the requisite opportunities required by due process to present evidence and cross-examine.

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[5] See also the Commission's *El Paso* opposition at page 16.

Yet, neither the Commission nor the Association even attempt to contend that the Commission's findings here are based on such a record. Nor do they deny that the Commission undertook to make its new and contradictory findings on a bob-tailed record supplemented by collateral materials purportedly subject to administrative notice. Instead, they retreat to the claim, founded on strict technicalities, that Petitioner had not taken proper steps either to present evidence or to challenge the Commission's findings based on these extra-record materials.

Thus, the Commission argues (Br. in Opp. p. 13), that "* * * [the] issue had been timely raised by the intervening municipalities in the original hearing and petitioner could then have attempted to rebut the evidence introduced to support the claim that the Commission should change from normalization to flow-through" (see also Association Br. in Opp. p. 13). This argument ignores the express recognition by the court below—that (Pet. App. pp. 38a-39a):

> "*At the time of the hearing* it was reasonable for the petitioner to rely on the Commission's then well-established policy of allowing normalization. It was not unreasonable for the petitioner to assume that the Commission's failure to offer witnesses on flow-through normalization [sic] indicated that the Commission had no intention to reverse itself" [emphasis supplied].

Further, the Commission argues (Br. in Opp. pp. 13-14; see also Association Br. in Opp. p. 14) that after the Commission severed the liberalized depreciation issue, Petitioner did not request to reopen the record and that it did not object to the Commission's reliance "on secondary sources for factual determinations."

Again, this argument ignores the clear fact that the Commission fully understood Petitioner's pleadings filed subsequent to such severance, as requesting *just* such a reopening and as objecting to *just* such reliance upon collateral materials. The Commission's opinion on rehearing explicitly notes that (R. 203):

> "Alabama-Tennessee * * * contend[s] that the Commission's decision herein was based on an insufficient record; on matters *de hors* the record; and *on findings contrary to facts which could have been established if another opportunity to present pertinent evidence was afforded*" [emphasis supplied].

Since the Commission was then fully aware of the scope of Petitioner's position *when it denied rehearing*, the Commission's efforts *now* (Br. in Opp. p. 14) to vindicate its action on the ground that Petitioner had purportedly failed to invoke certain Commission rules is obviously contrived and hypertechnical.

The arguments advanced by the Commission and the Association to justify the Commission's procedure herein, thus, in no way undercut the comment in our Petition (at pp. 20-21) that "the Commission's 'about face' was based on procedure which is not merely 'singularly eccentric,' but which operated effectively to deny a fair hearing to Petitioner and the natural gas industry in general." This is particularly so in light of the Commission's unmistakable implication (Br. in Opp. p. 14) that as far as it is concerned, its ruling in the instant case constitutes a determination of the flow-through v. normalization question applicable generally to the natural gas industry subject to its jurisdiction with sole permissible exceptions thereto being those companies which "present evidence showing that fac-

tual differences between their cases and Alabama-Tennessee's justify their continuing to use the normalization method."

CONCLUSION

For the foregoing reasons as well as those set out in the Petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE TENNESSEE VALLEY MUNICIPAL GAS ASSOCIATION IN OPPOSITION

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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BRIEF FOR THE TENNESSEE VALLEY MUNICIPAL GAS ASSOCIATION IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit (Pet. App., pp. 1a-43a) is reported at 359 F. 2d 318. The opinions of the Federal Power Commission (R. 126-177, 202-214) are reported at 31 FPC 208 and 31 FPC 928.

JURISDICTION

The judgment of the court below was entered on March 25, 1966 (Pet. App. p. 44a). The petition for a writ of certiorari was filed on June 23, 1966. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTIONS PRESENTED

1. Whether Congress in enacting Section 167 of the Internal Revenue Code, which gives taxpayers the right to use "liberalized depreciation" for tax purposes, thereby circumscribed the Federal Power Commission's right to fix just and reasonable rates under the Natural Gas Act on the basis of the utility's actual tax liability resulting from the use of "liberalized depreciation".

2. Whether Petitioner was denied the opportunity to present evidence in support of an allowance for federal income taxes in excess of Petitioner's actual tax liability.

STATUTES AND REGULATIONS INVOLVED

Relevant portions of the Natural Gas Act, the Administrative Procedure Act, and the Federal Power Commission's Rules of Practice and Procedure are set forth in the appendix to the Federal Power Commission's Brief in Opposition to the Petition.

STATEMENT

The Tennessee Valley Municipal Gas Association ("Association") is an unincorporated association. Its membership consists of ten Alabama, Mississippi, and

Tennessee municipalities,[1] each of which is engaged in the distribution and sale of natural gas at retail in their respective communities and environs.[2]

Each of the municipalities purchases its natural gas requirements from Petitioner at rates and charges which are subject to the jurisdiction of the Federal Power Commission ("Commission") under the Natural Gas Act, as amended. The Association's members account for over 80 per cent of Petitioner's sales of natural gas subject to the Commission's jurisdiction (Pet. App., p. 38a).

Petitioner filed four successive increases in its rates and charges to the Association's members. The Association was granted intervention in the proceedings by the Commission. At the consolidated hearing on the four rate increases, and in all subsequent phases of the administrative process, and in the court below, the Association was an active participant.

For federal income tax purposes, Petitioner takes a deduction for depreciation on the basis of one of the liberalized tax depreciation methods—the declining balance method[3]—permitted by Section 167 of the

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[1] *Alabama:* Athens, Decatur, Florence, Huntsville, Russellville, Sheffield, and Tuscumbia. *Mississippi:* Corinth and Iuka. *Tennessee:* Selmer.

[2] On July 14, 1966, the Association, an intervenor before the Federal Power Commission and the court below, filed in this Court a motion to be added as a respondent.

[3] Under the declining balance method the depreciation rate is applied to the cost of the property less accumulated depreciation. The initial first year rate can be twice the straight line rate. Assuming an automobile costing $2,000 and having a 5-year life, the first year's depreciation would be at 40 percent, twice the straight line rate, or $800. In the second year the 40 percent would be applied to $1,200 ($2,000 less $800) for an accrual of $480. The same procedure would be followed in the balance of the 5-year life. By contrast, under the straight line method, in the example given, the depreciation accural is $400 per year or at a constant rate of 20 percent per year. (R. 8-9).

Internal Revenue Code (26 USC 167). (R. 7, 9). As a result, Petitioner's deduction for tax depreciation is larger—and its tax liability smaller—than would be the case under the straight line method of depreciation which taxpayers, including Petitioner, were using prior to the enactment of Section 167 (R. 7).

Petitioner computed its increased rates, however, on the basis of a hypothetical, larger federal income tax liability related to the use of the smaller straight line method depreciation deductions. This was in accord with the rate-making policy the Commission had adopted sometime after Section 167 was enacted.

Under this policy, known as the "normalization" method, the Commission permitted utilities subject to its jurisdiction to include in cost of service taxes computed on the basis of using straight line depreciation deductions although they paid less taxes based on the use of liberalized depreciation tax deductions. This policy required consumers to pay higher rates on the basis of a hypothetical federal income tax liability in excess of the utility's actual tax liability.

Under the "normalization" method, a Reserve for Accumulated Federal Income Taxes was established to which was credited the difference between the actual taxes paid and the larger hypothetical amount for taxes. The theory was that in the later years of the property life depreciation deductions would be smaller under liberalized depreciation; that taxes consequently would be higher; and that the reserve in later years would be drawn upon to meet these higher taxes. In the meantime, the excess payments required of the ratepayers were available for all corporate purposes other than the payment of dividends or transfer to earned surplus.

At the hearing, the Association opposed the rate increases and the "normalization" method. The Association presented expert testimony in support of its position that the Commission was in error in following the "normalization" method in fixing natural gas rates, should abandon that method, and should compute Petitioner's federal income tax allowance for ratemaking purposes on the basis of the liberalized depreciation deductions Petitioner actually takes in filing its tax returns (R. 6-37). This is known as the "flow-through" method because the benefits of the use of liberalized depreciation deductions—the taxes saved —are "flowed through" to the consumer in lower rates.

The expert testimony presented by the Association in this case (R. 6-37) established that the use of liberalized depreciation tax deductions produces a tax saving rather than a tax deferral as the "normalization" method assumed; that sound regulatory principles required the allowance of only actual taxes; that such allowance works no discrimination between generations of rate payers, produces no instability of rates; would not jeopardize the financial integrity of the Petitioner; nor impede its ability to attract capital and to expand. The witness pointed out, in general, that the allowance of actual taxes enhances the ability of utilities to compete for markets by reason of the resulting lower rates.

The Association's expert witness was subjected to cross-examination by Petitioner's counsel (R. 37-42; Tr. 1404-1410, 1419-1425, 1446-1448),[4] but Petitioner presented no evidence in support of its contention,

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[4] "Tr." followed by the page numbers refers to the portion of the record certified to, but not printed in the court below.

electing to stand on the Commission's "normalization" policy as set forth in Opinion No. 326, issued August 10, 1959, in *El Paso Natural Gas Company,* 22 FPC 260.

The Examiner's decision (R. 57-60; 27 FPC 1202-1240), issued September 15, 1961, disallowed $515,000 of the increased rates, but rejected the Association's contention respecting the computation of the federal income tax allowance. The Examiner, following the "normalization" method, included in cost of service a hypothetical tax allowance, in excess of Petitioner's actual tax liability, which he computed by using the smaller straight-line deductions for depreciation instead of the larger liberalized depreciation deductions actually used for tax purposes by Petitioner.

The Association filed exceptions to the Examiner's decision (R. 61-63). The Association urged reconsideration by the Commission of its use of the normalization method. The Association directed the Commission's attention to its brief in opposition to California's petition for a writ of certiorari to review the Fifth Circuit's affirmance of a Commission order employing the normalization method,[5] where the Commission had said that the choice between "normalization" and "flow-through" was "only a discretionary choice among competing accounting systems" which did not warrant review by this Court and was a choice "which can be changed by the Commission should it become convinced that the other method is preferable." (FPC Brief in Opposition, *California* v. *Federal Power Commission,* No. 599, October Term 1960, pp. 11-12.)

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[5] *El Paso Natural Gas Company* v. *Federal Power Commission,* 281 F. 2d 567 (CA 5), certiorari denied, *sub nom. California* v. *Federal Power Commission,* 366 U.S. 912.

Thereafter, on June 1, 1962, the Commission issued an order in these proceedings severing the issue of the rate treatment to be accorded the use of liberalized depreciation from the other issues "because the Commission determined that it was appropriate to re-examine and re-evaluate" its policy "in light of" the Commission's more recent experience (R. 126); fixed a date for oral argument on the severed issue; and provided for briefs and the participation of interested parties as *amici curiae*. (R. 64). On June 13, 1962, the Commission issued a decision disposing of the other issues in the rate proceedings in order to produce "immediate refunds and rate reductions associated with these issues" (R. 67-98). The Commission fixed the interim rates on the basis of its existing "normalization" policy, because any change in its policy would be given only prospective effect (R. 88).

On May 16, 1963, Petitioner, the Association, and numerous amici participated in the oral argument on the liberalized depreciation issue. Thereafter, on February 3, 1964, in a three to two decision (R. 126-154), the Commission held that Petitioner's rates should be based on actual taxes paid (the flow-through method) and no longer on the basis of a hypothetical tax liability (the normalization method). On the basis of the allowance in cost of service of Petitioner's actual income tax liability, reflecting its actual tax deductions for depreciation, the Commission ordered a further reduction in rates of approximately $44,000 to consumers.

The Commission found (R. 153) upon "reexamination of the present policy of basing income tax allowances for a company which pays taxes calculated under liberalized depreciation on the deductions available

under straight line depreciation", that "there is no present factual justification for thus normalizing the prospective rates of Alabama-Tennessee" and that, therefore, its "rates should reflect only the actual taxes currently payable during the applicable test year in Docket No. G-19984 herein."

The Commission held that the choice between normalization and flow-through must not be based on "mere speculation and conjecture" but upon a "definite probability of higher future tax payments . . . in the reasonably foreseeable future" (R. 144, see also: R. 139). For rates "must be based upon presently known facts and factually based projections of pertinent future conditions" (R. 139).

It was necessary, therefore, "to evaluate the present necessity for continued rate normalization in the light of all pertinent facts and circumstances, affecting the likelihood that Alabama-Tennessee and other pipelines similarly situated will be faced with an actual increase in future taxes as a result of their current use of liberalized depreciation" (R. 144).

The Commission noted (R. 142) that this was the first case in which it "deemed itself legally free to bring its expertise to bear on the resolution of this factual issue," because prior to the decision of the court below in the *El Paso* case, *supra,* 281 F. 2d 567 the Commission had considered itself bound to follow normalization procedures due to an erroneous conclusion that Congress intended by Section 167 to deny to the Commission the right to determine the regulatory consequences of liberalized depreciation.

Reviewing the evidence, the Commission found (R. 143), that normalization is "premature and unneces-

sary as long as there is growth in the size of the dollar investment in gross plant," and even where gross plant investment levels off, unless in the latter situation leveling off "is shown to be the likely precursor of a decline in the plant."

Under conditions of growth and stability of investment, normalization forces the ratepayers "to provide funds to pay a hypothetical tax liability which may never become payable or, at the very least, to provide such funds many years in advance of the time when they are needed." (R. 143). In this connection, the Commission noted that between 1954, when Section 167 was enacted, and the end of 1962, forty of the larger natural gas pipeline companies subject to its jurisdiction had amassed $272,027,245 (R. 143), representing funds contributed by ratepayers under the normalization method for hypothetical tax liabilities that may never materialize. Petitioner's deferred tax reserve had increased from $17,481 in 1956 to $213,651 in 1963.

The Commission found also that the use of liberalized depreciation deductions for tax purposes "results in a permanent reduction of taxes payable to the Treasury Department by natural gas pipelines which maintain either a growing or stable plant" (R. 152); found as to Alabama-Tennessee that "the pattern of growth in demand and plant capacity . . . will continue for the reasonably foreseeable future" (R. 145-146); and found that "Alabama-Tennessee will maintain a growing or stable plant for the foreseeable future" (R. 152).

The Commission further found (R. 148) "that flow-through, rather than normalization, is the ratemaking treatment of the liberalized depreciation tax saving which, by permitting lower prices, will stimulate in-

creased consumer demand and corresponding additional investment in the pipeline industry as a whole and Alabama-Tennessee in particular." (See also R. 152).

Petitioner filed a timely application for rehearing which was denied (R. 100-109). Thereafter, it filed a timely petition for review.

The court below, in a unanimous decision, affirmed the Commission decision in all respects.

ARGUMENT

Petitioner rests its petition on two propositions, urged upon and correctly rejected by, the court below. The first is that Congress in enacting Section 167 intended to circumscribe the Commission's administrative discretion and expert judgment to determine and adopt the appropriate ratemaking principles under the Natural Gas Act (Pet., p. 11). The second is that Petitioner was denied procedural due process of law in that it did not have "adequate notice or opportunity . . . to cross-examine or submit rebuttal evidence" on the choice of methods (Pet., p. 11)

Nowhere in its petition does Petitioner challenge the Commission's findings that the use of liberalized depreciation produces a permanent tax saving, and not merely a tax deferral, as long as there is a growing or stable plant; that Petitioner will maintain a growing or stable plant for the foreseeable future; and that "there is no present factual justification for . . . normalizing the prospective rates of Alabama-Tennessee . . ." (R. 145-146, 152, 153). For normalization "during a period of growth or stability would force the ratepayers to provide funds for a hypothetical tax liability that might never become payable, or at the very least,

to provide funds many years in advance of the time they are needed" (Pet. App., p. 28a).

1. The court below twice (in the present case and in *El Paso Natural Gas Company* v. *Federal Power Commission*, 1960, 281 F. 2d 567, certiorari denied, 366 U.S. 912 (1961)), and two other courts of appeals (the Fourth Circuit in *Cities of Lexington, et al., Kentucky* v. *Federal Power Commission*, 1961, 295 F. 2d 109; and the D.C. Court of Appeals in *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 1963, 316 F. 2d 659, certiorari denied, 375 U.S. 881) have held that Congress did not intend by Section 167 to amend or modify the Natural Gas Act and thereby deprive the Commission of its discretion to choose the ratemaking principles which, in its expert and informed judgment, accord with the standards and objectives of the Natural Gas Act to "protect consumers against exploitation at the hands of the natural gas companies." (*Federal Power Commission* v. *Hope Natural Gas Company*, 1944, 320 U.S. 591, 611) and to "afford consumers a complete, permanent, and effective bond of protection from excessive rates and charges" (*Atlantic Refining Company* v. *Public Service Commission*, 1959, 360 U.S. 378, 388).

In the *El Paso* case, *supra*, the court below, accepting the Commission's erroneous view that the use of liberalized depreciation produced a tax deferral rather than a tax saving, approved the Commission normalization method. The court, however, expressly rejected the idea that "Congress intended . . . the rapid depreciation provisions of the Revenue laws to amend or modify the express language of the Natural Gas Act . . ." (281 F. 2d, at p. 572). Examining the legislative history, comprehensively, for the second time in this

case, the court below reached the same conclusion (Pet. App. 18a-27a).

Section 167 is a general tax statute applicable to all taxpayers. It gave them the option, for *tax purposes*, of using a more liberal deduction for depreciation. As a taxpayer, Petitioner continues to have the right to use liberalized depreciation in its federal income tax return. Congress did not, however, dictate the regulatory consequences which the Commission must give Petitioner's use of liberalized depreciation in performing the Commission's rate-fixing and rate review functions under the Act.

The tax statute applies to utilities whose operations are subject to the control of state regulatory commissions under statutes that they administer. The regulatory treatment of liberalized depreciation could not be dictated by Congress as to them. Under these circumstances, if Congress intended to proscribe the federal regulatory agency's freedom of selecting the appropriate ratemaking principles, it would be expected to use precise language to accomplish its intent as it did in the Revenue Act of 1964 in prescribing the regulatory treatment for ratemaking purposes of the reduction in taxes resulting from the investment tax credit. Section 203(e), P.L. 88-272, 78 Stat. 19-146. Congress has placed no such restriction in Section 167, thus indicating its intent to enact a tax statute only and to leave the ratemaking treatment to the expert judgment and discretion of the regulatory commissions.

Prior to the adoption of "normalization" for ratemaking purposes, the Commission consistently adhered to the principle that "consumers should be charged for only the actual tax liability for federal income taxes" *United Fuel Gas Company,* 12 FPC 251, 265. The

Commission strayed from this sound regulatory basis for a while because it erroneously believed that Congress had intended to circumscribe the Commission's discretion and expertise. Freed of that error, the Commission re-examined the matter and held on a record fully sustaining its findings that liberalized depreciation results in tax savings, not merely tax deferrals. The Commission is on a sound path again.

2. Petitioner's claim (Pet., p. 11) that it was denied "adequate notice or opportunity to cross-examine or submit rebuttal evidence" was properly rejected by the court below. The claim is contrary to fact and frivolous.

The court below correctly held (Pet. App., p. 38a) that the Association properly and squarely raised the liberalized depreciation issue in the rate hearings before the Commission and that Petitioner "received enough notice of its significance to have protected itself by rebuttal evidence before the end of the hearing." The Association presented expert testimony on the issue and, contrary to the present allegation of Petitioner, it was afforded full opportunity to, and did, cross-examine the Association's expert witness (R. 37-42; Tr. 1404-1410, 1419-1425, 1446-1448). Indeed, Petitioner did not object to the Association's evidence or move to strike it, and made no effort to bar consideration of the issue.

Petitioner presented no evidence in support of its position on the issue. Petitioner chose instead to rest upon Commission precedent, although the issue was highly controversial and was subject to continuing consideration by the Commission. Petitioner, of course, had the right to choose this course, and, in light of the

precedent, it may have been a reasonable one to follow. But, nonetheless, it was a course knowingly undertaken by Petitioner at its own peril. There is no basis, however, for the claim of denial of a fair hearing.

If there lurked in the situation at the hearing any question of procedural due process, the court below correctly found that it "evaporated" as the result of Petitioner's subsequent conduct, and "that the petitioner was not deprived of statutory rights or constitutional due process" (Pet. App., p. 40a). After the Commission severed the issue from the other issues in the rate proceedings and set it for separate consideration, Petitioner made no effort to reopen the proceedings to introduce evidence although the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 1.33(a) and (c) and the Administrative Procedure Act (5 U.S.C. § 1006(e)) make express provision therefor. Had Petitioner done so and been denied the opportunity, there might have been a due process question. But Petitioner never invoked the procedure; nor, in fact, did Petitioner make any request for an opportunity to present evidence at any time during the pendency of the issue before the Commission, even after the issuance by the Commission of the order affirmed by the court below. Moreover, Petitioner did not seek leave of the court below to adduce additional evidence although Section 19(b) of the Natural Gas Act expressly provides therefor.

The Commission had an adequate record before it which the Association made on which to decide the issue as to Petitioner's rates (Pet. App., p. 33a). There was no necessity or requirement for the Commission to reopen the proceedings on its own motion for additional evidence, and none had been brought to its attention by Petitioner. To this day, Petitioner

has never specified the "rebuttal evidence" that would have been adduced or by whom (Pet., p. 19).

CONCLUSION

Federal and state regulatory commissions, exercising their independent judgments, have divided in the selection of the method to be given effect to the use of liberalized depreciation. Some have selected "normalization"; others "flow-through"; some, like the Federal Power Commission, have first chosen "normalization" only to switch to "flow-through" as more experience has been acquired. (FPC Brief in Opposition). The Commission's abandonment of "normalization" and adoption of "flow-through" is not interdicted by any Congressional intent and is supported by substantial evidence. There is no basis for constitutional complaint since the method chosen by the Commission reimburses the utility for its actual federal income tax liability.

Since there is no conflict and since the decision below is correct, there is no more occasion for further review by this Court of the Commission's choice than there was when California in 1961 sought review of the Commission's earlier approval of normalization.

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No. 286

ALABAMA-TENNESSEE NATURAL GAS COMPANY,
Petitioner,

v.

FEDERAL POWER COMMISSION, ET AL.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR REHEARING

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November 4, 1966

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PETITION FOR REHEARING

Alabama-Tennessee Natural Gas Company, Petitioner herein, prays that this Court grant rehearing of its order of October 10, 1966, denying the petition for a writ of certiorari in the above-entitled case and that a writ of certiorari issue to review the judgment of the Court of Appeals for the Fifth Circuit in the instant case as prayed for in the petition filed herein

on June 23, 1966. In support of this petition, Petitioner respectfully shows as follows:

1. Critical to the determination of the ultimate issue herein is the matter of Congressional intent. All parties recognized that Congress, in enacting the liberalized depreciation provisions of Section 167 of the Internal Revenue Code, intended to encourage business investment and hence to stimulate the economy. The Commission, in its opinion, held that the reduction of rates resulting from passing through the benefits of liberalized depreciation would effectuate this Congressional intent. The Commission reasoned that lower rates would increase demand by stimulating purchases and thereby also stimulate the economy (R. 148-9). In our petition for certiorari (at pp. 14-18), we urged that Congress had specifically rejected such an *indirect* method of stimulating the economy and that it had rather intended, by Section 167, to provide a *direct* stimulus to businesses in the form of increased after-tax revenues and cash flow to businesses investing in new plant.

Since the issuance of this Court's order, Congress has enacted Pub. L. No. —, 89th Cong., 2d Sess. (H.R. 17607).[1] This legislation *inter alia* suspends the provisions of Section 167 of the Internal Revenue Code with regard to certain types of property constructed or acquired during the period from October 10, 1966, to and including December 31, 1967. The history and purpose of this legislation demonstrate that our read-

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[1] Although not signed by the President at the time of drafting this Petition, the new legislation reflects, in substance, his recommendations to Congress and, hence, undoubtedly will be approved within the constitutional period.

ing of the Congressional intent underlying Section 167 is correct and that that of the Commission is in error.

Thus, the Senate Committee on Finance, in recommending passage of the legislation suspending Section 167, described it as "an integral part of a coordinated anti-inflationary program * * *" (S. Rep. No. 1724, 89th Cong., 2d Sess. p. 1), and commented that "[b]y removing certain tax incentives for investment in machinery, equipment, and buildings, the bill will ease inflationary pressures in those sectors where demands for output are straining present productive capacity" (*Id.* at p. 4). One of the principal purposes of the legislation is to "* * * promote the early reduction in interest rates," which are "now the highest * * * since 1930" (*Id.* pp. 5, 11). Since, in addition, the suspension of Section 167 provided in the recent legislation is only for a relatively short period of time, Congress obviously envisioned the Section 167 stimulus (now suspended in part) as having operated *directly* as tax relief to business, not *indirectly,* as the Commission contends, through the time-consuming route of increased sales resulting from lower prices. That such was what Congress had in mind is further reinforced by the fact that, contrary to the attempted differentiation by the Court below (Pet. App. p. 23a, fn. 28), the Committee reports make clear that Congress regards liberalized depreciation as providing basically the same *direct* and *immediate* type of stimulus as that provided by investment tax credit.

2. The recent enactment of Pub. L. No. —— (H.R. 17607) is significant in still another respect. Both the Commission (R. 142) and the Court below have recognized (Pet. App. pp. 28a, *et seq.*) that the

Commission's finding that Petitioner's use of liberalized depreciation resulted in a permanent tax saving, not just a tax deferral, is critical to its ruling herein. According to the Fifth Circuit (Pet. App. p. 28a): " 'below normal' depreciation in older assets is counter balanced by 'above normal' depreciation on new assets *as long as the company continues the use of liberalized depreciation* and continues to make at least some capital additions." (Emphasis supplied)

However, while the Court below went on further to recognize that the Commission conclusion was based on a "reading of the future" (Pet. App. p. 33a), it failed to take into account, in affirming what it characterized as Commission "clairvoyance" (*Ibid.*), the possibility that Congress might suspend and even repeal Section 167. This, despite the fact that the Commission, in arriving at its conclusion, expressly declined to allow for such possibility, stating "[w]e cannot justify the imposition of tax burdens upon the ratepayers on the basis of suppositions and speculations as to the course of future amendments of the Federal income tax laws" (R. 139).

While the suspension provided in the new Act does not extend to all new investments by pipeline companies, the new statute does withhold the " 'above normal' depreciation"—needed on the Commission's thesis to achieve a tax saving—with regard to new buildings acquired or constructed by pipeline companies during the suspension period. Thus, the new legislation effectively undercuts the basic thesis of the Commission.

The new statute also forcefully demonstrates that the possibility of substantial modification and even

repeal of Section 167 is not to be brushed aside lightly and hence, contrary to the Commission, must properly be taken into account in determining whether liberalized depreciation results in a tax deferral or a tax saving. To this should be added the further fact that the other findings on which the Commission based its tax saving conclusion are highly controversial; are admittedly speculative; are in sharp contradiction to the Commission's own findings when it had viewed liberalized depreciation as resulting in a tax deferral; and are themselves founded upon predictions and estimates culled from secondary sources *de hors* the record and not subjected to the test of cross-examination or rebuttal. Since the Commission's ultimate finding of "tax saving" is thus patently founded upon weak reeds, whereas the consequences flowing therefrom are admittedly important and far reaching, the affirmance by the Court below of the Commission's conclusion plainly calls for review by this Court.

For the reasons set forth above and in the petition for writ of certiorari, it is respectfully submitted that rehearing be granted and that, upon such rehearing, a writ of certiorari issue to the Court of Appeals for the Fifth Circuit.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 58 of the rules of this Court.

STANLEY M. MORLEY

November 4, 1966